Journal of Accountancy

Volume 58 | Issue 5 Article 9

11-1934

Journal of Accountancy, November 1933 Vol. 58 Issue 5 [whole issue from bound volume]

American Institute of Accountants

The JOURNAL *of* ACCOUNTANCY

Official Organ of the AMERICAN INSTITUTE OF ACCOUNTANTS

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VOL. 58 NOVEMBER, 1934 NO. 5

EDITORIAL

Individual Practice or Partnership?

One of the problems which confronts many accountants in these difficult times is the question whether to continue in individual practice or to seek association in the form of partnership with other individual practitioners. It is rather common to find among comparatively small practices that the bulk of a practice may be dependent upon the caprice of one large and important client. There are probably countless instances of individual practices whose gross business consists largely of the work involved in one audit, and if that be taken away the condition of the practitioner is extremely unfortunate. This fact is one of the most serious aspects of modern accountancy. Its effects are unfortunate in many ways. For instance, if an accountant has one client infinitely more important than all the rest of his clients together, he is more than human if he is not somewhat unduly influenced by the bread-and-butter question. He may, if he be at all subservient, be inclined to deal rather leniently with the demands of the client lest his livelihood suffer grave diminution. Uncertainty as to the continuance of a fair level of practice makes for a lack of that peace of mind which every professional man should enjoy if he is to do his best. In such circumstances many accountants are thinking of the possibility of buying other practices or of entering into partnerships with other accountants, so that the loss of one or two important clients may not be so serious a factor as it would be under present conditions.

Tact and Good Nature Are Needed

This raises the further question of the desirability of partnership. It is true that all the large and so-called national firms are partnerships having many partners, and it is not recorded that there is any great difficulty in carrying on such practices without the appearance of jealousies, of acrimonious differences, between the members of a firm. The strength lies largely in the multitude of partners. It is a well known axiom that a group of men can agree much better than two or three men. Where there are many men engaged in one office, no two of them are apt to be brought into daily and irritating fellowship. On the other hand, a partnership consisting of two or three or even four practitioners is a severe test of the good nature and the patience and tactfulness of each individual partner. Perhaps there is an analogy here with the supposed peacefulness of a Turkish harem and the unhappiness of many a monogamous union. Every man who enters into a small partnership—and by small we mean in number of partners—must be ready to concede a good deal for the cause of harmony. Two men who have practised individually and have achieved a certain amount of success will find it difficult to forego an absolute individuality for the sake of the partnership. We have no statistics to prove our contention, but we believe that personal differences of opinion have broken up more partnerships of two members than partnerships of any other number whatsoever. There are many things to be said in favor of partnership. There is certainly less overhead expense in one office than in two; there is the inestimable advantage of consultation between partners; and there is, of course, as we have said, the highly important increase in the aggregate number of clients which tends to bring about a more even plane of practice. It seems to be a question for each man to answer for himself, whether he can enter into a sort of conjugal relationship and still retain that friendship which is essential in all partnerships which are to endure. The man who is naturally set in his ways will not succeed in a partnership unless he has been trained for many years in the custom of give-and-take, which is one of the most important parts of firm relationship. The kindly and good-natured fellow who believes that some one else may know as much as he knows, or possibly more, may enter into a partnership without grave fears of the result.

Partnership Not to be Lightly Entered

If business as a whole had remained upon a substantial basis and if there had been no such appalling depression as we have passed and are still passing through, there would not be so much consideration of the possible desirability of joining practices. Probably the happiest man in accountancy is he who practises alone with a comparatively small staff and can give his personal supervision to every task that he undertakes. If anything goes wrong he has himself alone to blame. In a partnership, whether small or large, there is always the possibility of an error which is in no way attributable to some of the partners, who may know nothing of the work which has been done and may never even see the financial statements which bear the firm's certificate. But the growth of national industrial and commercial concerns has required the building up of great firms of accountants which can undertake the audit of a company whose ramifications spread into every state of the union and into many foreign lands. Every accountant, of course, desires to make money. Probably very few professional men would continue in practice if the question of money were not a consideration. It is the common belief that the partners in the larger firms receive more substantial revenues than individual practitioners. Consequently there is always a trend toward consolidation for the purpose of increasing profits. We have been asked to express the opinion of THE JOURNAL OF ACCOUNTANCY as to the desirability of partnership practice as opposed to individual practice. The only reply which we can give is based on the words of St. Paul, "Let a man examine himself" before he undertakes the burdens, the difficulties and the uncertain outcome of partnership.

The Foolishness of Competitive Bidding

According to reports in the press a board of education called for bids for the audit of the books and records for the past five years. The bids submitted ranged from $800 to $9,800 —surely a sufficient difference to indicate that there was no collusion between the bidders. A difference so great as this is, of course, ridiculous. As we have said many times, either the low bidders did not know what the work would entail or the high bidders, if they knew, hoped to make an exorbitant profit. It is much to be regretted that the twenty-seven concerns which competed for the audit did not recognize the fallacy of the whole system of competitive bidding and did not refuse to bid. That is a question which need not be discussed at this moment. The point that is of special interest now is the extraordinary range of prices. If the board of education consists of business men with a knowledge of business practice the incident reveals in the minds of the board members an altogether unfortunate misconception of accountancy. If it were a matter of buying a commodity such as coal, for example, and the prices quoted differed by anything like so great a percentage, the members of the board would doubtless feel that the matter called for investigation, and some of the bidders would find themselves condemned for lack of common business knowledge; but when it is a question of professional service that is in the balance, many persons overlook the fact that business sense plays as great a part in the fixing of prices for work as in the quotations for commodities. It may be that there was some misunderstanding as to the amount of work to be done, but even so there seems to be no valid excuse for the $800 bid or the $9,800 bid. One of them must be altogether awry. It does no good to any profession to demonstrate the ignorance of its members. Men will be apt to say that the costs of rendering a service must be very small, and consequently the higher bidders are engaged in pursuit of unholy gains. And this brings us back to the old argument that there is no advantage whatever in the principle or practice of calling for bids for professional work.

Who Shall Choose the Auditor?

Our attention has been directed to a statement appearing recently in a monthly magazine to the effect that one of the duties of the controller of a corporation is to select the auditors of the corporation, subject to the approval of the executive committee. This is an extraordinary statement and if it were founded upon a prevalent custom it would be serious. It is not, however, true in many instances. The controller of the modern corporation is not infrequently the treasurer, and even if the two offices be separate the controller is so closely concerned with receipts and expenditures that he may be classified in the same category as the treasurer. It would be rather ridiculous in such circumstances if the selection of the auditor were left to the controller or the treasurer, because it is his accounts that are subject to audit. Doubtless many controllers would like to have the right to select auditors, but it seems to us that the controller is the last person in the world who should be intrusted with that important function, and we doubt if most controllers would consent to make the selection. Of course, we have not yet come to the common acceptation of the English practice for the selection of the auditor by the share-holders. We have, however, advanced beyond the point where the man whose accounts are to be audited is given the selection of the auditor. It is bad enough to have the directors appoint the auditors, because the directors themselves are the agents appointed by the owners to carry on the business. In most cases the directors are probably animated by an earnest desire to choose the auditors best qualified to make an independent investigation and to render an unbiased report, but, as has been said innumerable times, the selection should rest with the owners of a business who are, of course, the share-holders. Probably we shall come ere long to a common adoption of something resembling the English practice. It has worked admirably in Great Britain and would be equally effective here. The old argument that share-holders in America are indifferent and prefer to leave all administrative affairs to directors is not so convincing as it once was. In these days of shrinking values, share-holders are beginning to pay more attention to the direction of the affairs of the companies which they own. Every dollar received and spent is of more importance than it was a few years ago. When a company is earning substantial dividends and paying them there is less impulse to scrutinize carefully the conduct of affairs. Now, when only a few corporations are paying dividends and millions of people own shares in corporations, there will be more investigation by share-holders. In such circumstances we expect to hear of increasing adoption of the English system. It would then be an inexcusable backward step to take the selection of auditors from the directors and place it in the hands of the controller or the treasurer. The tendency is toward decentralization, not toward the concentration of direction in one or two men's hands.

Needless Detail in Reports

We have frequently emphasized the desirability of presenting accounts in a way which even the ordinary layman may understand. The form of presentation known as narrative has been much commended because it seems to make possible a fairly accurate understanding of the facts, which, every one must admit, is not always obtainable from the traditional form of financial statements. It is, however, possible to go too far in the attempt to attain clarity. We have before us a statement or story of accounts which seems to us to err on the side of too much detail. In the so-called comments on the audit we find several paragraphs explaining the nature of the work done by the auditor, all of which was eminently proper and in accordance with common practice, but we fail to see why it was necessary to burden the report with quite so much explanation. Certainly nothing can be gained by asserting that the auditors carried out the fundamental principles of audit. That much should be inferred. It seems to us that it is only necessary to draw attention to unusual conditions which call for unusual investigation. It is easy to run to extremes, particularly in the search for righteousness. The reader of such a narrative as that before us may become somewhat weary if not actually confused by its voluminous character. It is an old principle of the newspaper world that the story should be told in the fewest and shortest words compatible with full exposition of the facts. If there is to be expansion for the sake of human interest or fine writing that is not the duty of the reporter. The accountant who performs an audit is concerned only with a clear and precise explanation of what he finds. The danger of the narrative form of balance-sheet is that it can run to absurd extremes. The form when kept at its simplest is eminently desirable, but it should not develop into a lengthy dissertation of principles. What can be said in a few words is seldom better said in many words.

A Questionable Use of Certificates

A correspondent writes to draw attention to a condition which he believes may be somewhat common, although we confess that few instances have been brought to our knowledge. He refers to offers to undertake accounting services by concerns which are not composed of professional men, or at least are not composed of men who hold state certificates as certified public accountants. He says that he has heard of cases in which firms or corporations have offered to undertake audit engagements and have guaranteed that the work would be done by certified public accountants. Having no certified public accountants in the firm or corporation, he says that it is the custom to engage certified men for these particular jobs and let the supervision of the work be entrusted to them. When it is done the certificate is signed by the company and a clause is inserted in the certificate to the effect that the work is that of certified public accountants. Legally there may be no bar to such procedure—but of that we are not sure. It is certainly very close to the borderline of illegality. Its impropriety is obvious, because it is very much like misrepresentation. Many state laws prohibit the use of the words "certified public accountant" unless the signers are certified. Surely it does not require any great stretch of interpretation to read into such a law an inhibition against anything which might lead the reader to believe that a certificate existed where in fact it did not. In the earlier days of accountancy there were certain audit companies whose owners and directors were not professional men. They employed accountants to do the actual work and in so doing they did not apparently infringe any law, but the growth of public knowledge of the nature of accountancy and its extremely intimate and confidential capacity militated against the success of such adventures, and today the unprofessional company is almost unknown. If a company engages accountants who are certified in order to comply with the requirement of the client, very much the same deplorable condition results; and it is difficult to understand the reasoning of a client which will induce the acceptance of a certificate which is in fact not purely professional.

C. P. A.'s Obligation to the State

And something should be said about the certified public accountants who are employed in such cases. Every one knows that at the present time there are countless men out of work, some of them well qualified certified public accountants, and the temptation to undertake whatever will produce a livelihood is tremendous. Nevertheless, we believe that a man who holds a state certificate, which is an evidence of the state's confidence in the professional ability of the holder, should hesitate before accepting any employment which will lead to a debasement of the professional standards. If an accountant is out of work and is offered employment of an honest kind, he would be foolish to refuse it, but when he is employed solely because of the state's expression of confidence in him, he should not do anything to prostitute that official approval. In other words, if a man is asked to lend his assistance to the perpetration of a plan which is not strictly professional, he should refuse, whatever the cost of his refusal may be. A certified public accountant should never drag his official designation at the tail of a cart. As we have said, we do not hear of many instances of this kind, but the correspondent who supplies the present information is much perturbed about it—and indeed if there be one such case it is one too many.

Institute's Annual Meeting

The annual meeting of the American Institute of Accountants, which was held in Chicago, Ill., October 15th, 16th, 17th and 18th, was, in point of view of attendance, the largest meeting which the Institute has ever held. Nearly every state in the union was represented and there was naturally a great number of Illinois accountants. The papers were interesting and the discussions indicated a general desire to participate. The number of speakers after every paper was greater than usual and many of the discussions were well worthy of careful attention. The social part of the proceedings was as delightful as Chicago's well-known hospitality would lead one to expect. Every year the meetings of the Institute seem to grow in importance and effect. The men who meet year after year grow to be close friends and the old fear of rivalry or competition seems to have passed. Nothing makes more surely for the upbuilding of the professional spirit than this annual gathering together of men from all parts of the land.

Montana Act Held Unconstitutional

The supreme court of Montana has rendered a decision on the constitutionality of the certified public accountant law of that state which is of vast importance and will, we believe, be received with gratification by the practising accountants of the entire country. Its effect should be far reaching. The original C. P. A. law of Montana was enacted in 1909 and has been amended twice since that date. The latest amendatory act was approved March 6, 1933. Section II of the act reads in part as follows:

"The university may waive the examinations and may issue a certificate in such form as to clearly indicate the conditions under which same be issued to any applicant who is possessed of the other qualifications hereinbefore recited, and who shall be . . . (3) employed as state accountant, corporation licence tax auditor, state examiner, or assistant or deputy state examiner, and who shall have been so engaged exclusively and continuously for at least four years preceding the date of his application for said certificate and who shall apply in writing to the university . . . within sixty days from and after the date of passage and approval of this act."

Within the specified time limit seven men, who occupied the positions under the state designated in section II, applied for certificates, and certificates were prepared for delivery to them. The plaintiffs in the case, A. J. Roberts, and others, brought a proceeding in the district court of Lewis and Clark county to enjoin the delivery of the certificates. The citation is *Roberts et al.* v. *Hosking et al.* No. 7176.

We now quote from the finding of the court:

"The complaint filed alleges that the exception of these state employees from the requirement of examination is discriminatory and in violation of the bill of rights of both the federal and state constitutions, and violative of the equal protection and due process of law clauses thereof (Const. U. S. Amend. 14; Const. Mont. art. 3 Par. 3, 27), and of sections 3, 11, 14, 27, 29 and 30 of article 3 of our constitution, and that 'there is no basis at all, nor any reasonable basis, for the classification and exemption.' Many other attacks are made upon the act on constitutional grounds.

"To this complaint the defendants interposed a general demurrer, which was argued to the court and submitted on the argument and briefs furnished, and, after due consideration, the court overruled the demurrer. The defendants refused to plead further, electing to stand on their demurrer. The court then heard testimony on behalf of the plaintiffs, which is not in the record, and finally made and caused to be entered the judgment to which reference is made above.

"While the complaint challenged the constitutionality of the act as a whole, as well as that of the exemption clause, the court held only the exemption and so much of the act as was necessary to carry it into effect unconstitutional, and it is therefore only with subdivision 3 of section 2 that we have to deal.

"The regulation of public accountants has existed, without challenge, since 1909 (chapter 39, laws of 1909; chapter 72, laws of 1919, which became chapter 231, revised codes of 1921). The purpose of this regulation is to protect the financial interests of the public by authorizing the university to determine the qualifications of accountants holding themselves out to the public to act in that capacity, and to certify only those who are up to the standard set.

"Section 10 of the act defines a 'public accountant' as 'one who offers his services professionally [as an accountant] for pay to the general public'; and a 'certified public accountant' is such a one 'who shall have received a certificate as such under this law or prior laws of the state of Montana, or some other state.' The act, therefore, is intended to apply only to those accountants who make a business of serving any member of the public in need of such service in private business and not to those employed in a single business enterprise or by the state in its governmental capacity.

"It is asserted that the exemption here is in the nature of an award for public service, which is not a legitimate ground of exemption. It is held that exemption on account of service in time of war violates the uniformity clause of state and federal constitutions (*McLendon* v. *State*, 179 Ala. 54, 60 So. 392, Ann. Cas. 1915C, 691; *In re Humphrey*, 178 Minn. 331, 227 N. W. 179), and that the exemption for licence of one employed in a state institution, while requiring it of those engaged in private practice, is discriminatory (*Jackson* v. *State*, 55 Tex. Cr. R. 557, 117 S. W. 818).

"However, it would seem that the underlying idea in the act before us is not reward for public service, but rather that four years' service in the positions named should endow those so employed with the requisite skill and technical training to insure the safety of the public, should they, on leaving the employment of the state, launch out as public accountants. Certainly they are not 'public accountants' while in the employ of the state, within the meaning of the act; they do not offer their services to the public.

"A case more nearly in point than those cited above is that dealing with the exemption of those who have served five years as court reporters from taking the bar examinations, on the evident theory that, in the time fixed, a court reporter would absorb sufficient law to render an examination unnecessary. (*In re Grantham*, 178 Minn. 335, 227 N. W. 180, 181.)

"Whether or not their activities as state employees, in the several capacities mentioned, are sufficiently diversified to qualify these defendants who seek certificates by compliance with the provisions of subdivision 3, above, as 'accountants,' within the meaning of the act, is at least doubtful.

"While the term 'accountant' is, for certain purposes, defined as 'one who makes the keeping or examination of accounts his profession' [*United States ex rel. Liebmann* v. *Flynn* (D. C.) 16 F. (2d) 1006, 1007], or 'one skilled in keeping or adjusting accounts' [*Frazer* v. *Shelton*, 320 Ill. 253, 150 N. E. 696, 697, 43 A. L. R. 1086], in contemplation of the purpose of certifying public accountants, such definitions are not sufficiently comprehensive; those to be reached and controlled fall within the broad definition found in the *Encyclopædia Britannica*, where it is said: 'The term . . . is sometimes adopted by bookkeepers, but this is an erroneous application of the term; it properly describes those competent to design and control systems of accounts required for the record of the multifarious and rapid transactions of trade and finance.'

"The work of the exempted state employees, as we understand it, is largely concerned with the auditing of the work of others, which is but one phase of accountancy which embraces skill of designing systems of accounts, bookkeeping, and auditing. But whether or not the four years' work of these men would qualify them as public accountants and justify the exemption of all those who at any time have this qualification from taking the required examination, we need not here determine. No such exemption is found in the act; on the contrary, the challenged subdivision presumed to exempt only those who come within the provisions of the subdivision at the time of its enactment, and exempt them only provided they make application for a certificate within sixty days after the approval of the act. These limitations mark it as special legislation. 'A statute which limits its operation to those who are within its provisions at the time of its passage or within a limited time thereafter is special legislation, forbidden by the constitution.' *In re Grantham*, above.

"Subdivision 3 of section 2 of the act is violative of the prohibition in the final clause of section 26, article 5, of our constitution, which reads: 'Where a general law can be made applicable, no special law shall be enacted.'

"The defendants cite the decision in *State ex rel. Marshall* v. *District Court*, 50 Mont. 289, 146 P. 743, Ann. Cas. 1917C, 164, wherein the law requiring the registration of nurses was held to be constitutional, as supporting their contention here, because that act contained an exemption somewhat similar to that here in question (see section 10, c. 50, laws of 1913), but that decision merely held that the act requiring the registration of professional nurses did not violate the 'due process' clause of the constitution; the validity of the exemption clause therein contained was not considered nor the clause mentioned in the opinion.

"As the challenged exemption clause unquestionably comes within prohibition of the constitution, the judgment must be affirmed."

Emphasis Upon the Word "Public"

This decision by the highest court of Montana should serve as a precedent which will be of great assistance to the administrators of C. P. A. laws elsewhere. There have been repeated attempts by state employees and by employees of the federal government to obtain certificates as certified public accountants without examination, and in some cases these efforts have succeeded. The profession, however, has always felt that there was no justification at all for classifying as certified public accountants men who were not engaged in the public practice of accountancy. Indeed, we can see no reason why employees of government should desire a classification to which they are obviously not entitled. The very nature of the designation, certified public accountant, seems to remove from its sphere persons who are not engaged in public accounting. Every judgment which strengthens the position of the certified public accountant's certificate is to be commended by every one whose professional activity is protected by the C. P. A. laws. The recent decision in Montana will rank alongside the decisions of the supreme courts of Oklahoma, Illinois and Tennessee (declaring unconstitutional certain undesirable phases of the laws in those states) as tending to buttress the whole scheme of C. P. A. legislation against the attacks of self interest and special class legislation.

Uniform Accounting for Industry*

By Charles B. Couchman

By uniform accounting some who have discussed this subject conceive apparently the adoption of a complete code of principles for all industry, which will answer fully the vexing problems of proper analysis of all financial transactions. Few could object to the uniform adoption of such a code of principles provided there were any wise enough today to devise such a perfect code. A further interpretation of the phraseology goes beyond the code of principles and indicates the establishing of procedures for recording the effects of transactions so that all transactions of similar nature throughout the industry may result in identical accounts in every business in which such transactions occurred. This implies a preliminary determination of all possible results of transactions and a system of accounts sufficiently comprehensive to designate an account for each possible effect. A third conception of the term embodies not only the first and second, but, in addition, includes a uniform set of rules for the proper combining of these accounts into uniform financial statements. In the application of this conception, all balance-sheets and other statements presented to management, to stockholders and to the public would be identical in layout for all business organizations coming under its control.

These various interpretations seem to differ only in degree, but a further concept applies to all, in the minds of many who discuss this subject. This concept includes the legal authorization and enforcement of all the points involved, usually involving a preclusion of all variations therefrom, such enactment to be final, unless amended.

While the subject seems to involve tremendous complexities, my opinion with regard to its essentials may be expressed in a brief and simple creed, consisting of only three tenets:

1. I believe in uniformity of presentation for those elements which are completely uniform.
2. I believe that it would be misleading to express, as though they were uniform, elements which essentially are not uniform.

*An address delivered at the Annual Meeting of the American Institute of Accountants, Chicago, Illinois, October 16, 1934.

3. I believe that it is unwise to attempt to compel uniformity of characteristics in elements for the mere sake of uniformity in presentation.

As an illustration of the first tenet, I believe that the amount of cash in any organization may properly be reported uniformly under the heading "cash," provided such cash is, in its essentials, uniform in all cases, that it is all expressed in the currency of the same nation and that there are no restrictions upon its present availability at full face value for the liquidation of the liabilities of the organization or for the carrying on of its activities. However, if a portion of this cash is in closed banks, or if a portion is represented by funds in other countries which have restrictions regarding its withdrawal, or if, in any way, any portion of this cash is subject to limitations as to its free and available use or may be affected by fluctuation in exchange, the element of complete uniformity is lacking, and it can not rightly be expressed under a simple and unqualified heading. Such restrictions would bring the presentation of this element under my second tenet. I do not approve of misleading presentation of financial facts.

If an authority which should prescribe uniformity of presentation of financial facts should approve the first two tenets but, in order that it may establish a uniformity of presentation, should attempt to limit the characteristics of elements so as to bring the number of possible elements within the scope of a limited scheme of uniform presentation, the attempt would be most unwise and would be impossible of enforcement. To prohibit transactions producing financial elements other than those provided by the uniform system applicable to a specific industry, would result in much bootlegging of transactions, some of which, if we may judge from experience, may be better than those permitted by law.

Let me summarize these points by stating that I am not theoretically opposed to any properly devised scheme of uniform accounting for industry that will be in keeping with the three tenets I have stated. Such a scheme would be in harmony with the ideals of the accounting profession. We have endeavored to present in financial statements a reasonably uniform expression for elements that are uniform in character; and we have endeavored to avoid grouping together elements that are essentially different in their financial significance. There are, however, definite practical limitations to the extent to which such segregation can be carried into brief financial statements. In this respect, accountants have had to exercise their individual judgment as to the extent of classification advisable in the presentation of the financial affairs of a particular corporation, in order that the information presented may be as complete and as useful as possible and may avoid misleading groupings. The accountant's judgment must be exercised in each case, depending upon circumstances and conditions.

The advocacy of uniform accounting for industry is based upon the expectation of certain accruing advantages, the more important of which are (1) simplicity of operation, (2) the securing of accurate information in a form most readily usable, particularly for purposes of comparison and (3) the aiding of individual industrial companies by giving to them comprehensive and definite instructions as to their financial records, thus relieving them of any uncertainties in this respect. From the standpoint of regulation by authority, an additional advantage appears in that, having laid down very definite rules regarding the presentation of each financial fact, any violation of the rules is more readily detectable.

Before we accept any assumption that these advantages would result from the adoption of uniform accounting by all industry, it is well to give some consideration to each one.

Anyone who has given intensive study to the recording of financial transactions is aware of the fact that the simplicity or complexity of the records is to some extent governed by the simplicity or complexity of the transactions to be recorded. In other words, it is not possible to provide a simple method of accurately and efficiently recording the results of complicated transactions. The minimum, therefore, of simplicity of records and procedures is set by the minimum of complexity in the characteristics of the transactions to be recorded. When one recognizes that, in the majority of lines of industry, there are organizations which vary greatly in the type of transactions which they make—some being concerned with fairly simple operations, others which run the gamut to a very high form of complexity—an immediate doubt is aroused as to whether the adoption of a uniform system for all the organizations in a class of industry would result in a marked gain of simplicity, either of recorded result or of the procedures necessary for the recording.

In order that we may form some judgment as to the accuracy of the financial statements presented as a result of uniform accounting, it is necessary to give thought to the effect of such a system upon the various factors that must become its subject matter. The usefulness of information must depend upon its accuracy. Therefore, any consideration of its utility, whether for comparison or for other purposes, must be postponed until it is made clear that the information presented as the result of uniform accounting is sufficiently accurate to accomplish that for which it is intended.

The adoption by individual industrial companies of complete uniform instructions concerning each item of procedure in the analysis and recording of their transactions and in the display of the accumulated results may be disadvantageous to some and advantageous to others, depending in a large measure upon the extent to which such uniform system differs from the system previously used and upon the extent to which such a system meets definitely the individual needs of each company. It is conceivable that there might be cases in which the time and effort expended in attempting to fit the transactions of a particular company into the definite pigeonholes provided by the system might more than offset any advantages that the system might provide. To render any judgment as to the extent of such advantages again requires consideration of the various factors which constitute the subject matter of the system's operations.

Factors concerned:

These factors include the following matters with which accounting systems are definitely concerned:

(1) Accounting principles and their application.
(2) Procedures involved in analysis of financial transactions and synthesis of results.
(3) Financial accounts wherein similar effects are accumulated and certain opposing effects are offset.
(4) Financial statements in which the accounts are summarized and arranged for display according to certain recognized principles and conventions.

Complete uniformity of accounting for industry implies the adoption of uniform principles governing the recording of financial transactions, a uniform classification or chart of accounts in which similar results may be accumulated and a uniform set of financial reports or statements for the purpose of displaying the periodic balances in these accounts. Such a trilogy would seem to mark the ultimate in the unification of accounting for industry. To the casual observer unfamiliar with the intricacies of transactions, such a planned uniformity is appealing.

A detailed study, however, of accounting principles, of accounting procedures and of financial statements may disclose difficulties in applying uniformity and unexpected dangers resulting from such application, together with some view of the problems involved in devising such a system with advantages outweighing its disadvantages.

Accounting principles:

The various principles governing the determination, the analysis and the presentation of financial facts may be divided, at the present time, into three groups:

(1) Those principles which have been evolved as the result of thought, skill and experience and are quite generally accepted as being true.

(2) Those principles which, at the present time, are debatable or with regard to which there are optional treatments, the predominance of trained opinion not having as yet come to a decision that would justify transference to the first group.

(3) Those principles as yet hidden, unknown or unstated which our thought and our experience have not as yet enabled us to discover or to recognize or enunciate.

In the adoption of a uniform set of principles at the present time, the first group indicated above might properly find a place. They already are being applied to American industry, not only by the public accounting profession but by the trained accounting staffs of industries. With regard to the second group, there would be danger that the authorities might adopt as final a principle which has not been proven to be sound or they might arbitrarily decide upon one or another of present optional treatments without definite knowledge that they have chosen the proper option.

Another danger would lie in the fact that the third group—those at present unknown principles—might never be discovered. Accountancy still consists, to a large extent, in exploration work. The adoption of a rigid set of principles might debar continued exploration so that principles or procedures which might be of infinite help to economic progress might continue to remain beyond the horizon of our thought and experimentation. Such an unfortunate condition is certainly not within the desire of any proponents of uniform accounting, but it is a possibility that must be given consideration and should delay any act that might result in producing such a condition.

Accounts:

Before passing to consideration of uniform financial statements, let me mention briefly a few of the problems that must be faced in financial accounts in which must be accumulated the effects of detail transactions, and those which provide material for financial statements. Uniformity of financial statements presupposes uniformity in underlying accounts. Practically all attempts at uniform accounting have involved the devising of a uniform chart of accounts for all groups of organizations concerned.

A chart that would provide all accounts that would be necessary or desirable for all industrial organizations would reach a size far beyond the possibilities of efficient use. No one business could utilize more than a small percentage of such accounts. If the use of such a chart of accounts were made compulsory, the ledgers of all business enterprises would be of the same size and their use would be expensive, confusing and highly inefficient. On the other hand, if each business were allowed to select from the chart of accounts only such accounts as would seem to meet its needs, a question would arise as to the authority that would pass upon the omitted accounts for each such business. The solution first appearing for this problem would be to classify industries into groups, designating to each group a list of the accounts which the members of that group would be required to keep.

Consideration was recently given to this problem by an organization which found that at least 1,400 such groups would have to be segregated. To provide a proper chart of accounts for each of these 1,400 groups would be an herculean task. In each chart each account would have to be defined, stating specifically what should be included in it. Assuming, however, that that task were performed and that 1,400 charts of accounts were properly devised, the problem would not by any means be fully solved. No man has yet been wise enough to forecast the transactions of tomorrow. Undoubtedly, if one may make any prophecy as the result of past experience, the chart would no sooner be fully completed and installed than a business would discover that in its particular enterprise some new account or accounts would be needed. By the time these were duly approved by whatever authorities were constituted to pass upon such matters, then other demands for additional accounts would have to be considered, and this procedure would be repeated ad infinitum.

For each of the 1,400 charts of accounts, forms of financial statements would have to be devised so as to group the contents of the accounts into a condensed presentation that would show the proper essentials of balance-sheet, income and expense account and surplus analysis. Many businesses, however, are not confined to any one of the 1,400 classifications but might embrace a number of them. There are commercial organizations today which operate factories, mines, transportation systems, construction, stores, hotels, restaurants, real-estate development and operation and numerous other operations. Adjusting to the needs of such an organization the various charts of accounts devised for its differing activities, so as to present the proper periodic financial reports, involves difficulties that may not have been given due consideration by those who advocate the adoption of uniform accounting procedures for industry. This is not to say that the thing can not be done. My only point is to call attention to the fact that the benefits that might be derived from such uniformity must be offset by the expense and the disadvantages and may perhaps be outweighed by them.

Practical accountancy has as one of its goals the obtaining for each business organization that financial information which is essential for its welfare and for the interests of its investors and its creditors and to obtain such information by the most direct and inexpensive methods conducive to accuracy. This can be accomplished only after a study in each business of the types of its most frequent transactions and the procedures most readily adaptable to reach the goal, giving consideration to the number and the skill of the organization's internal staff. Such studies can not be performed wholesale. To be most effective, they must be individual studies of the business. To demand complete uniformity of accounting procedures by all the members of a group following the same class of commercial activity would unquestionably work a hardship and put an unnecessary expense upon some members of the group.

Financial statements:

It may well be that the establishing of uniform accounting for industry, if undertaken, should begin with the financial statements: namely, the balance-sheet, the operating statement (however named) and the analysis of surplus. Since the primary purpose of uniform accounting is presumed to be the giving of information to those who read the financial statements of organizations and to give the information in such a form that comparisons may readily be made between one organization and another, it seems logical to believe that any movement of this character must center in those statements which are put forth by organizations to their stockholders and to the public. With a uniform set of such financial statements, I think that public accountants would have no quarrel, provided the statements were so perfect that in each instance they would give a proper presentation of facts that would not be misleading. I admit, however, that such a set of statements is beyond my power to conceive. I fear that, if the preparing of such a set of statements were presented to the American Institute of Accountants as an undertaking which it was its duty to perform, dismay would enter into the heart of even the ablest and the most experienced member of the organization. Such a member would realize the immensity of the task and, looking back through his experience at the numberless cases where specific treatment and presentation of facts had to be devised in particular instances in order that the resulting statement should, as truly as possible, present the proper facts, he would wonder how these numerous cases could be properly developed by a statement, uniform, rigid and inflexible. To him it would appear that under such a system justice could no more be given to the innocent reader of the financial statements than could justice be obtained by the devising and establishing of a uniform code for determination of cases brought before a court, thus eliminating in specific cases the opinion of juries and the discretion of the judge.

Upon a balance-sheet the classification of current assets on the one side and of current liabilities on the other has been deemed of considerable value, and accountants have given much thought, in individual cases, to the question exactly what items should be included and what excluded from the classifications. These items are not the same in every company nor are they always the same in different companies in the same industry. An item that should be included in the current assets of one organization may properly be excluded from the current assets of another organization.

A uniform balance-sheet designed for all industry, or even a uniform balance-sheet designed for a specific industry, could scarcely be made sufficiently flexible to permit a proper display of current assets and of current liabilities in every organization which would be compelled to use the form. Discretion and judgment are necessary in each case, but results depending upon specific judgment and discretion are not compatible with the term "uniform." In other words, a uniform accounting system, if I understand the term correctly, involves a predetermination of the method of treatment of each item involved so that there will be no necessity and, unfortunately, no opportunity for the exercise of discretion.

An interesting problem in the development of a uniform balance-sheet for industry would be the making of proper provision for the recording of the asset represented by "investments." Some organizations, having surplus funds, invest them temporarily in securities with the expectation of converting them into cash as the need arises for more liquid current funds. In such a company these investments belong fundamentally in the current-asset group, being even more liquid than the majority of the assets in that group. Another corporation, building up or acquiring funds for the specific purpose of financing an additional plant, may in the interim invest such funds in securities. In this case, the investment partakes more of the nature of a fixed asset, even though the intention is to convert the securities into cash at an early date. The deciding factor is the purpose for which the cash is to be used.

Another corporation, instead of acquiring actual ownership of plants directly associated with its own operations, such as plants supplying it with raw materials or organizations distributing its product or plants manufacturing an integral part of its product, may instead obtain a similar result by acquiring sufficiently large blocks of the capital stock of other corporations performing the required functions. Its investment in such capital stocks is akin to its own investment in fixed assets, and a proper picture of the financial status of such a company would show the close relationship between such investments and the company's own fixed assets. In some corporations, such as holding companies and certain types of trusts, the entire capital assets or earning assets consist of investments. In still other companies, investments may represent compliance with the sinking fund provision of some trust agreement with provisions for the liquidation of certain long-term liabilities.

Any uniform balance-sheet for industry which provided a certain space on the asset side definitely fixed as the place for recording "investments in securities" would present anything but uniform results in the cases of the various companies just mentioned. Comparisons of balance-sheets of these various companies would result in highly misleading conclusions. This disadvantage would be increased if no provision were made for description of the use or the purpose of such an item. On the other hand, if, in such a balance-sheet, provision were made that the item of investment in securities could be displayed in its proper place in each instance, with opportunity for clear explanation of any specific information regarding the item that might be necessary for a clear understanding of its purpose, there might be some doubt as to whether or not the resulting balance-sheets would come under the term "uniform," as understood in its more rigid sense.

In the forms of balance-sheets intended to be strictly uniform for an industry, provision would have to be made for all of the possible assets, liabilities and capital accounts that might be deemed desirable for any member of that industry. Strict adherence to the form would require many such balance-sheets to contain items of such minor nature that they do not deserve a place in a display properly prepared for the individual companies. Such a result would be confusing rather than illuminating. Readers of balance-sheets are justified in assuming that any classification expressed thereon is of sufficient importance to justify attention. As a result, such readers would be misled in many cases. Undue emphasis would frequently be placed upon items of minor import. It is conceivable also that in a particular organization there might be facts that should be brought to light, for which no provision was made, with the result that a strict compliance with the required form might prevent the disclosure of information of real importance.

Statements of profit and loss:

The financial statements other than the balance-sheet present many perplexities to one planning to evolve uniform displays that will be more informative and more useful than those now in use and that will be less liable to misinterpretation.

In a uniform financial statement presenting operating results, an important item would unquestionably be "cost of goods sold," in the determination of which, for a manufacturing concern, cost of goods produced would be an essential factor. This is a phase of accounting to which a great deal of thought has been given both by accountants and by industrial staffs, and noteworthy progress has been made in developing within industries a certain amount of uniformity in the methods of determining cost of manufactured product. The primary purpose is to give information to the management itself, so that it may not be deceived as to the true cost of its product, and further to attempt to equalize to a reasonable degree the variations due to fluctuations in volume of production. Any benefits that have resulted from the adoption of such methods within an industry have been advantageous both in the prevention of unfair trade practices and in preventing organizations from losing money on their product without being aware how the loss occurred. Here, the uniformity, however, has been primarily limited to uniformity of principles of cost determination rather than to uniformity of result or uniformity of display. These systems, also, where they are most successful, have allowed a flexibility sufficient to care for the various elements and circumstances affecting specific organizations.

If cost of goods produced is to be determined by a uniform formula for all industry, a number of problems will have to be solved. Or, if a separate formula is to be established for each industry, many perplexities will remain to be faced. Let us, for a moment, consider just a few. Let us assume that the formula decrees that the cost of manufactured articles shall consist of the total cost of material actually used, plus the cost of direct labor, plus an amount to be determined for overhead. Each of these three elements allows a wide range of interpretation, and, unless each is determined with particularity by the authority, there would not be uniformity of result in the industry. In regard to each of these, there are, at the present time, numerous methods, all reasonable and all found acceptable by able cost accountants. However, if uniformity of result were to be obtained, uniform procedures would have to be established for each organization to follow.

To illustrate a few of the points: How shall the amount of material consumed in production be measured? How shall scrap, spoils, shrinkage, waste and similar items be spread over the good material used? Or shall they be treated otherwise? Which particular "cost" of material shall be used? Shall cost be on the basis of "first in, first out" or shall it be on "average cost" of raw material in stock, or shall it be by "specific determination" or on market value at the date used? What dividing line shall be decreed as separating direct labor from indirect labor? Shall labor cost be apportioned through machine units? If so, what other elements will be included in machine-unit cost? Will machine-unit cost be spread on a time basis or unit-of-production basis? In either case how shall idle machine cost be apportioned? As to overhead, the problems are multitudinous. Which elements shall be included in overhead? Shall it include interest on investment? Shall it include depreciation, taxes, insurance? Shall an effective rent be determined as a portion of it? Shall a portion of managerial expense be included in factory overhead? A portion of executive-office expense? What proportion? How shall overhead be spread? On the prime-cost basis? On a material basis? On a direct cost basis? On a specific allocation basis? Or shall it be on some combination of these? If by specific allocation, who will determine that allocation? Will that also be set as standard for all members of an industry or will it be worked out specifically for each factory? If so, by whom?

I am not attempting in this discussion merely to oppose uniform cost finding by pointing out some of the problems it must solve. Rather, I want to indicate that there are innumerable methods that would have to be decided on and established arbitrarily. I have mentioned only a few. Any cost accountant can supply the remainder of the thousand. The chief point I wish to emphasize here is that some authority would have to determine a rigid set of rules and procedures for ascertaining cost in an industry. Any such set of rules and procedures would unquestionably favor some factories and penalize others within the same industry. To attempt to provide a fixed formula for cost determination, to apply alike to numerous industries, would be verging on the bizarre, however skilfully done, and might develop into the ridiculous.

Cost accounting on any scientific basis is of fairly recent origin. Tremendous advance has been made in it, but a belief that it has now reached a point where all its problems are so well catalogued and solved that a uniform set of equitable rules could be devised, even by the ablest group of cost accountants, would be disproved on the instant. To select for each step of cost finding one of the various optional methods now applied, and to embody these selected ones into a complete system to be followed uniformly by all the members of even one industry would be to place a bar upon further experiment and improvement. The bar might be hurdled, but why place it in the present stage of cost-finding development? The possible advantages should be carefully weighed against the possible disadvantages of such a step.

Space permits this one illustration of an item on the statement of profit and loss. In regard to numerous items of income and expense, any attempt to lay down absolute rules of determination and of presentation would produce, in many cases, results far from satisfactory. Either the results would not be wholly uniform or, in many instances, would be misleading. The single item of depreciation would present many difficulties if absolute rates were insisted upon for every classification of depreciable assets. Such rates would inevitably prove to be unfair to certain organizations, too high for some and too low for others. Unless provision were made for periodic adjustments to ascertained conditions, recognizing differences in maintenance, care and the relative engineering skill applied to the use of the assets, such arbitrary rates would diverge materially from the actual depreciation suffered.

The progress that has been made in recent years in the development of financial statements by industrial staffs and by public accountants, supported by outside organizations definitely interested in these statements, such as the New York stock exchange, the Robert Morris Associates and the various organizations of credit men, is worthy of emphasis. It is further to be noted that this progress is continuing and should be aided and encouraged by all parties interested in developing financial statements to the point of highest usefulness. To set the present accomplishments as a fixed standard would be highly detrimental to further improvement.

History of uniform accounting:

In considering the advantages and the disadvantages of uniform accounting, one must study the results of experience in those cases where uniform accounting has been in use for a number of years. Perhaps the most complete establishment of uniform accounting has been that laid down by the interstate commerce commission in its control of common carriers. All who are familiar with this system in its application to the financial statements of railroads recognize certain facts. The first is that years have been spent in the development of this uniform system and this development has been expensive. The second is that, from an accounting standpoint, the financial statements resulting from its use have not appeared wholly satisfactory. Many illustrations might be given of the failure of such financial statements to present facts as truly or as clearly as they have been presented by the financial statements of organizations not subject to such uniform control. Recently, it was found that, in the case of one railroad, the annual statement of net income over a period of ten years was, apparently, ten to fifteen per cent. greater than the true net income for that period, even though each annual statement was doubtless correctly prepared in accordance with the interstate commerce commission's requirements.

In a recent work entitled *Security Analysis*, by Benjamin Graham and David L. Dodd, the comment is made, on a case in which railroad earnings are said to have been distorted, that "These instances are the more impressive because the stringent accounting regulations of the interstate commerce commission might be expected to prevent any misrepresentation of earnings."

In many states, uniform accounting for public utilities has been prescribed by public-service commissions, yet there are instances where reputable firms of public accountants have been compelled to state the financial results of public utilities in a form different from that prescribed by the public-service commissions before they would certify to such statements, or else they have felt it necessary to qualify their reports by stating that the accounts had been set up in the form required by the public-service commissions. It is doubtful if the statement could be truly made that investors in public utilities have been better protected, because of the uniform accounting requirements obligatory upon such companies, than have the investors in enterprises not subject to such uniform accounting.

In certain states, the commissions responsible for the granting of permission to sell capital stock within those states under the so-called "blue sky laws" have, at times, provided forms for balance-sheets and for income statements which, if fully complied with, would not give a proper presentation of the financial facts of the corporations required to use them. In some cases public accountants have felt compelled to refuse to sign their names to statements presented in this manner but have insisted upon signing separate financial statements so set up as to give what they considered to be a more accurate and informative presentation of the financial facts.

Under the national recovery administration, certain industries with accepted codes have devised or have attempted to devise uniform accounting for the industries coming under such codes. Recently, an executive of a large, efficient and trustworthy organization made the statement that, if he were compelled to use the cost system records and other forms designed for his industry, he would have to keep a complete additional set of records for his own use for managerial purposes, as the following of the required forms would result in statements that were inaccurate and misleading and would be useless for purposes of internal control over his departments and over his costs. The public accountant in this case agreed with the executive on each point.

It is doubtful if the various attempts to prescribe uniform accounting or uniform financial statements, made not only in the United States but also in other countries, have resulted in more accurate and more useful statements than have been obtained where uniform accounting restrictions do not control. There is a strong opinion, expressed by many who have given intelligent thought to the subject, that the greatest progress in the improvement of accounting methods and statements has been accomplished where no such restrictions prevailed. It must not be overlooked that minimum requirements almost always become maximum accomplishments.

Continuing development:

During the last thirty years great progress has been made by the profession of accountancy in the study of transactions and of financial operations with a view to analyzing effects. From this study certain principles have emerged with sufficient clarity to enable us to state them in more or less definite terms. Many of these principles have been stated in technical books and articles. The profession, however, lays no claim to having completed this work. Accountants of vision recognize that they have entered into a field of investigation so broad that their work in the devising of principles is yet in its infancy. That accountant is rash indeed who would state that he had so mastered the subject that he knew and could state in definite terms all principles needed properly to interpret every accounting problem. The profession of accountancy contains some able men, analytic by nature and training, clear in thought and definite in expression. If this body of men, devoting their whole lives and energies to this subject has not been able in the generations that have passed to complete the great work of determining results that will approach perfection, dare any other body of men claim the ability to devise such a code of principles and to say that their work is final?

A thing may appear excellent from the standpoint of theory but may prove to be unsatisfactory when faced with the limitations of practical application. One of the great handicaps to progress in all sorts of human activity lies in the difficulty of keeping theory and practice properly equalized. A theory that is not practical is of small value. Practice that is not in accordance with sound theory does not produce the best results. If theory were not subject to practical application, the world long ago would have reached Utopia. Perhaps in no fields are there greater difficulties in adapting theory to practice than in fields in which human characteristics play a vital part. Theories of reform, however beautiful, stub their toes upon the obstacles of human frailties and human characteristics. Idealistic theories of government and enticing theories of economics stumble over the same obstreperous obstacles.

It may be considered that the theories promulgated relative to financial accounts are not subject to such handicaps. Accounts are inanimate things. In practice, however, we find that the items represented by accounts, for which accounts are merely symbols, are not entirely free from human entanglements. Receivables must be collected from persons. Payables are to be paid to persons. Fixed assets are to be used by people. All assets are under the custody of people. They can not, therefore, be entirely removed from the uncertainties that attach to human behavior. Their value, to some extent, may be affected by human characteristics. Financial statements, therefore, are impregnated to a large extent with human elements and, to that extent, the difficulties of applying uniformity are increased. This is not to say that uniformity of classification, of treatment, of display can not be applied to them advantageously. It does imply, however, that too much credence must not be placed upon the exact similarity of elements similarly displayed.

In the present trend toward uniformity of accounts, as principles are developed to a point where their true significance is recognized by the accounting profession, they are given effect in the great majority of financial statements of importance that are presented to the proper authorities, to the creditors, to the stockholders and to the public. As each new method of presentation is found to be more valuable in aiding a proper understanding of the financial affairs of an organization, it is given effect voluntarily in the leading financial statements put forth to interested parties. It is a continuous growth, a gradual development tending steadily toward the goal of perfection. Until that goal is reached, the development will be hampered by any authoritative rule that would set as a standard this partial realization of the ambition of the profession. Any strait-jacket applied to this growing art would stunt future development and improvement.

If dispite the innumerable difficulties, some of which I have referred to briefly, any governmental body should proceed to devise some system of uniform accounting, it appears to me essential that, in order to avoid distressing and disastrous effects, that governmental body must be one that would have a keen appreciation of the progress thus far made and a proper realization of the possibilities of future improvement. To my mind, no congress or legislature would be suitable for such a purpose. Such bodies consist of a diversified group of persons, differing materially in their experience with financial matters, in their viewpoint with respect to economic development and in their ability to attain that full realization of what has been accomplished and that alert recognition of what may yet be developed in the way of accounting principles and procedures that would enable them to establish a control over financial statements and records and would allow proper freedom for the exercise of judgment and opinion and would be sufficiently flexible to take advantage of every improvement that might be proved to be of worth. It seems to me, instead, that the only governmental body that could undertake such control, without seriously jeopardizing the advantages already gained and those to be attained, must be a small body or commission whose members are carefully chosen because of their possession of the very qualities I have indicated as being essential to the proper development of the advantages and to a restriction or elimination of the disadvantages so apparent in any establishment of an involuntary system of uniformity for the financial accounts of industry. Such a commission, to be an asset to industry and to those affected thereby, must be willing and able to utilize every principle and procedure that has been found to be for the greatest advantage of the greatest number. With regard to those principles and procedures which are optional, it must allow sufficient leeway so that no organization shall be forced to follow arbitrarily one principle or one procedure when an alternate principle or an alternate procedure might be more beneficial. Such a commission must follow closely the development of new principles and new procedures so that, when any one of these has proved that it produces a more beneficial result than has been attained previously, it shall be added to the roll of requirements, always weighing, in each instance, the offsetting advantages and disadvantages of such addition to the list.

Uniformity:

To give intelligent consideration to the matter of uniformity, one can not overlook the definitions of the essential words in the subject. So far as this discussion is concerned, the emphasis must of necessity be upon the limiting word "uniform." One finds, among other meanings given by the dictionary, two that are pertinent: "to make uniform or conformable; to clothe with some specific livery." This definition is worthy of some analysis.

The first section of it implies an enforced uniformity which apparently implies uniformity of characteristics and of usefulness. Applied to many mechanical devices uniformity has proved its value. This is the type of uniformity that is developed by the bureau of standards of the United States government in the case of certain mechanical products. Uniformity has been decreed for many things—such as the spacing of threads on nuts and bolts, the size and threading of electric light bulbs and sockets, the minimum dimensions of garments that are designated by size numbers. A uniform gauge for railroad tracks has enabled the cars of one road to move over the tracks of another road. In these developments of uniformity great inconvenience to the public has been eliminated and costs of manufacturers have been reduced. The advantages of these various rules have far outweighed their disadvantages. The American people have accepted gladly many of these rules of uniformity despite the fact that they prize highly the liberties of individuality and of initiative. It is possible that they would resent the indefinite carrying of the principle of uniformity into all activities, even those of a material nature.

In moving from objects of a purely mechanical and utilitarian purpose to items in which professional knowledge, judgment, skill and art play a part, the advantages of uniformity become less apparent and the disadvantages become more formidable. In the various professions, or those arts in which the constant search for knowledge and for improvement plays an active and important part, the thought of uniformity may reach the characteristics of a menace. If uniformity were applied to medicine and rules made rigidly applicable as to the specific treatment for each symptom or combinations of symptoms, the profession of medicine would probably reach the end of its growth and the death rate would rise instead of decrease. If uniformity were applied to literature and music, or to the expression of art through form or color, all of these essential adjuncts of civilization would become drab and uninteresting. There is, therefore, a limit to the successful application of uniformity without its resulting in stagnation or retrogression.

If we were to consider this section of the definition as being the one applicable to any proposed action with respect to specific accounting for industry it would imply an attempt to compel uniformity of characteristics of items to be grouped under each heading. Any one familiar with the elements comprising the financial affairs of business organization realizes that this uniformity of characteristics could only result from a uniformity of transactions and procedures. In other words, having decided upon the proper classifications of the results of transactions, prohibitions would have to be inaugurated with reference to any transaction that would produce results different from those for which provision was made. Such a procedure for an American people is almost inconceivable and it is doubtful if it has even been given any consideration by the advocates of uniform accounting.

At the risk of repetition, I want again to emphasize the fact that in dealing with problems of this character both theory and practice must be considered and I believe reconciliation of the two constitutes an achievement. Theory is principle; practice is experience. Theory thinks; practice acts. Theory says; practice does. Theory idealizes; practice penalizes. Theory plans; practice proves. Theory says all men are uniformly entitled to their right to life, liberty and the pursuit of happiness; practice proves that not all men are equally efficient in exercising these rights. Theory says that all shall be equal, all shall be good, all shall serve alike, all shall receive alike. Practice proves that each man still possesses some will towards self-determination and insists upon exercising it. Practice demonstrates that some debar themselves from life, some debar themselves from liberty, some debar themselves from service; some debar themselves from reward. As there is diversity of interest, so shall there be diversity of effort. As there is diversity of ambition, so shall there be diversity of result. To decree uniformity of reward regardless of accomplishment would merely magnify the abortion of justice.

Let me pass to the other phase of the definition of "uniform" as quoted above, namely "to clothe with some specific livery." This implies a superficial uniformity—a uniformity of those elements that meet the eye without necessitating uniformity of characteristics other than those of appearance. This is the common use of the word "uniform." If we consider that this effect is the one underlying consideration of uniformity in the accounts of industry we immediately recognize that the results might be highly misleading and even dangerous. People who are fundamentally interested in the financial accounts of industry are concerned not with the superficial appearance but with the vital forces for profit or for loss that underlie the accounts. Uniformity in outward appearance gives no assurance of uniformity in the vital essentials beneath the livery.

While this may possibly appear to be a wide departure from the proper subject matter of this discussion I am nevertheless convinced that it must at least be given some consideration. Students of life and of the reactions of humanity are well aware of the fact that to many the fixed idea of uniformity as a goal within itself has become more or less a fetish. This peculiar mental trait is all too prevalent and invades many realms of thought including the fields of economics and of politics. There are schools of thought and political parties which are endeavoring to produce as nearly as may be uniformity of the most essential phases of life. They recommend enforced uniformity of performance and of reward. Absurd as such a view may be considered, there are nevertheless indications that even in the United States such theories are gaining new converts and new advocates. It seems unnecessary to spend much time in pointing out the fallacies of such a so-called philosophy, for these fallacies must be evident in every-day life. One who believes in uniformity of human characteristics has only to deal with many people to be undeceived. One who believes that uniformity of label is assurance of uniformity of quality has only to experiment with some of the liquors bearing labels of high renown. If one believes that uniformity of appearance or classification guarantees uniformity of value, let him survey the engraved certificates of guaranteed mortgages, bonds or capital stock that repose in his safety deposit box.

A study of history discloses a continuing cycle of opinions regarding regimentation. There is nothing new in the word or in its meaning. At root it always indicates certain persons who desire to make rules which all other persons will have to follow. It is a manifestation of a human characteristic common to most of humanity. Each of us frequently wishes that others would think just as we think, would like what we like or would be wise enough to make all their actions conform to what we consider best for them. The word "uniform" suggests armies where dictation of superior rank is absolute. It suggests the elimination of individuality, of initiative and of progress. Uniformity of presentation may be highly misleading unless uniformity of essential characteristics be made the basis of classification.

If we apply this to accounting systems we return to the major consideration of present-day public accounting, which has for its goal the grouping together for display of those items which are sufficiently similar to justify such grouping but to allow sufficient range of expression so that unusual conditions or characteristics in a particular organization may be set forth clearly, so that there shall be no omission to state material facts and so far as possible shall so state them as to prevent a misleading presentation.

One of the greatest purposes of mankind lies in the creation and distribution of wealth (in other words, the operation of "business"), with the constant purpose of increasing the average standard of living. Toward this goal, the United States has advanced farther than has any other nation in modern history. In this accomplishment individuality and initiative have played an important part in the developing of things undreamed of in preceding decades. Even initiative and individuality of expression have their disadvantages as well as their advantages. Just now the disadvantages are in the limelight, and we are in danger of overlooking the advantages which for the time being are somewhat in eclipse. When a star is in eclipse, people of short sight may believe that it has vanished from the heavens, but the wise know that, after a brief passage of time, it will re-appear undiminished and untarnished. During periods of economic disturbance there will always be those whose faith is brief and who will point toward eclipsed systems and say, "Look! they are gone forever!"

Arguments may always be offered for and against everything in this complicated world. There is little that is wholly good or wholly bad. It is the part of wisdom to study the relative effect of advantages and disadvantages and to determine in which case one outweighs the other.

In a wise weighing of the advantages and disadvantages of our modern economic system we can not overlook the disadvantages which have been brought so forcibly to our attention, and we must strive to find right methods for eliminating or at least for minimizing such disadvantages. This must be done, however, with careful consideration of possible effects upon the advantages, so that we may be sure that what we do will not ultimately result in greater loss than gain. During this process it is well also to study advantages in the hopes of devising means for encouraging them and increasing their effectiveness. In any endeavor the goal must be the constant increase of the predominance of advantages over disadvantages, measuring each of these in its effect not upon the few but upon the many.

In the development of commerce in the United States, complexities of organization and of transactions have reached an unprecedented amount. To what extent this has been good and to what extent it has been bad I am not prepared to say. I think we may state, however, that in this development much has been accomplished that is of value, despite the fact that many procedures, good in themselves, have possibly passed the point where the law of diminishing returns in the form of value to the nation has affected the results. The recording of the financial effects of the results of operations has passed beyond the mechanical and the arithmetical stage into the realm of skilled opinion and judgment. Facts that may be recorded with mathematical accuracy are readily subject to uniform rules. When the determination of effects lies more within the realm of judgment and of skilled opinion than it does in the realm of exact science, any attempt at uniform, predetermined rules tends to hamper rather than to aid. Judgment and opinion are not subject to codification, without jeopardy to the continued development of human welfare.

Summary:

I have tried to make clear my personal opinion of the possibility of uniform accounting for industry and to indicate that advantages must be put in the scale with possible resultant disadvantages, for I take it as being beyond question that the establishing of a uniform system of accounting is only an attractive proposition if the advantages that result are greater to industry and to all those interested in or affected by industry than are its costs and its disadvantages. I say I take this for granted because I can not believe that any great number of people interested in the welfare of this country would wish to establish such a system merely for the sake of adding one more to the list of things being put into "uniform." In other words, uniformity for the mere sake of uniformity is absurd; and yet I know that there is a growing tendency at present to consider that uniformity as applicable to everything is itself a goal.

It has been difficult in the space allowed for this talk to consider fully all the phases presented by the subject. Nevertheless it is evident that in the consideration of accounting for industry as a whole, or for individual industries, we face a definite fact. Certain financial elements are sufficiently alike in their characteristics to justify uniform presentation. Other financial elements are not. For the first, a uniformity of display for facts essentially uniform is desirable. In the second group, if uniform accounting be adopted, we would face the necessity of giving a similar display to items that were essentially dissimilar or of attempting to force a change of characteristics—a limitation of characteristics—for the sake of uniformity. In the creed expressed earlier in this paper I stated that I considered it misleading to clothe with a semblance of uniformity elements that were essentially different in their characteristics, values and effects; and, further, that I considered it unwise to attempt to enforce uniformity of characteristics through a limitation of the type of transaction which produces the elements.

Uniform accounting is apt to be static and limited as to its classifications. On the other hand, the development of business activity is more or less unlimited and the combinations and permutations that are within the range of honest and efficient business activity frequently produce results not anticipated by any preconceived schedules of classifications, however elaborate. I do not say that a scheme of uniform accounting for business is impossible, but I am convinced that such a scheme, that would not be misleading or cramping in its effects, can only be evolved over a long period of time and even then should be sufficiently flexible to allow for changes to meet changing conditions. Human evolution in the great undertaking of making a living is not static nor has it reached, nor will it ever reach, its ultimate.

Progress in the future may be as great as progress in the past. Imagine a uniform system inaugurated fifty years ago and based upon a complete comprehension of the business activity of that time. Further imagine attempting to fit into such a system the ramification of elements and of results that exist in the industry of America today. May it not be similarly true that a rigid system devised and enforced today would be equally unsuited for the industry of tomorrow?

So far as the aims of the advocates of uniform accounting for industry are to produce more useful statements approaching more nearly the goal of accuracy in their results and reducing to the minimum any misleading elements, these aims are also the aims of the public accounting profession, ably supported by the efficient leaders of industry. In the accomplishment of these aims, however, it is essential that full recognition be given to the fact that financial displays, either as expressed by balance-sheets or by statements of income and expense, are not merely mechanical results in which nothing is involved save labeling, adding and subtracting. On the contrary, skilled experience and an understanding of practical economics play their vital part in the selection of the label and in the determination of the amounts to be added and subtracted. Figures in themselves are rigid and inflexible, but the part they play in the final result is akin to the part played by the letters of the alphabet in the presentation of opinions and philosophies. It is difficult to reduce such use of figures to rigid rules without affecting the value of the results.

So far as the aims of the proponents of uniform accounting center upon the word "uniform," in an endeavor either to reduce all elements to a limited number or to limit all legitimate option to certain chosen procedures, or to give an appearance of uniformity unsupported by substance, the aims are contrary to the spirit actuating the accounting profession; for such aims could only result, on the one hand in setting a barrier to development and to progress toward more idealistic reports and on the other hand in distortion of the truth.

Since all the worthy aims of the friends of uniform accounting are also the aims of the accounting profession, and since the latter has been instrumental in attaining a degree of uniformity justified by experience and is constantly striving toward further attainment, it would appear to be wise to support the profession in this continuing work and to leave the matter in its hands, with such coöperation as can be given by business organizations and by government.

Accounting for Creamery and Dairy Products

By John H. Worman

Dairying had its beginning in antiquity, at a time when nomadic tribes roamed over wide areas seeking pasturage for their flocks. In these simple surroundings, the art of butter-making also originated, probably when some traveler found his milk churned to butter after a long trip on camel's back.

After long years of evolution, we have our modern creameries and dairies. The first creamery should, in all probability, be credited to the Swiss, who early sent their cows to a central organization in the upper pastures, where most of the milk was made into cheese, and each farmer was paid in due ratio, according to the yield of his few cows. Modern creameries and dairies are said to date from 1866, when the first distributing society was founded in Denmark.

Through the use of modern machinery and equipment, milk is now converted into several varieties of dairy products, with annual sales running into billions of dollars, so that dairying and its allied industries rank, approximately, fifth in the United States.

Milk production is highly technical, because of legal requirements of cleanliness, etc., and competition is so keen that the margin of profit is very small.

The large dairy usually purchases its raw products from small dairy farmers. The raw milk is delivered daily by the producers, either to small creameries, milk shipping stations or direct from the farm to the dairy plants, where the milk is subjected to chemical and bacteriological analyses and is put through several processes before it is ready for delivery to our homes.

The main products, which are the results of processes and manufacturing operations to be discussed later, are here briefly described in order that the accounting methods set forth later may be better understood.

GRADES OF MILK

Under standard milk ordinances, now in effect in most cities, the following grades of milk are produced:

Grade A (raw) Bacterial count not to exceed 10,000 per cubic centimeter at the time of delivery.

Pasteurized:

Grade A	Bacterial count same as Grade A raw milk.
Grade B	Bacterial count not to exceed 50,000 per cubic centimeter at time of delivery.
Grade C	Bacterial count not to exceed 50,000 per cubic centimeter,—used only for cooking and manufacturing purposes.

The minimum milk standard is as follows:

Butterfat	3.0%
Milk solids	8.5
Water in fluids	88.5
Total	100.0%

CREAM

Cream is extracted by separating it from the skimmed milk in the process of utilizing surplus milk, or else it is purchased outright. It is produced in grades ordinarily known as "heavy," "medium" and "light" cream. Cream, both sweet and sour, is sold direct to the trade, and the surplus is churned into butter.

MANUFACTURED PRODUCTS

Buttermilk:

Buttermilk is made from milk, from which the butterfat has been removed. The milk is heated to a temperature of approximately 180° for a period of one hour to kill all harmful bacteria, and then it is cooled to 70° before being inoculated with lactic acid bacillus, which produces what is known ordinarily as buttermilk. Bulgarian buttermilk is similarly produced from whole milk by inoculation with lacto bacillus bulgaris. The bacteria are allowed to propagate for 18 hours at 70°, after which the curd is broken, cooled, stirred to a creamy consistency and bottled.

Cottage cheese:

Cottage cheese is fresh curd of milk, produced by allowing bacteria to grow for a time in skimmed milk. The curd is cut into small bits, and heated; the whey, or watery portion is then drained off, after which the curd is cooled, washed and mixed with cream and salt.

Butter:

Butter is produced by churning cream, and is composed approximately of:

Butterfat	80%
Milk solids	1

Salt	3
Water	16
Total	100%

Other by-products:

The great variety of dairy products such as powdered or condensed milk, cheese, ice-cream, etc., make it impracticable to attempt to discuss them all, and these comments will be confined to the operations of fluid-milk dealers, who manufacture buttermilk, cottage cheese and butter mainly to utilize their surplus milk.

FUNCTIONAL DEPARTMENTS

Functional control of costs and expenses is made possible by proper departmentalization. Departmental expenses fall, naturally, into two classes, as follows:

1—Producing
2—Non-producing

Under producing come purchasing, processing and manufacturing, while non-producing includes sales, administration and service departments.

PURCHASING

When the milk is delivered to a plant, it usually is received by two employees, who weigh and sample it by taste for freshness and flavor. Since butterfat content is the basis on which milk is purchased, samples must be sent to the laboratory for testing. These tests are made eight or nine times monthly (or as agreed) and the tests are averaged at the end of the month. The average serves as the basis of settlement with the shippers.

The receiving employees make a duplicate report on each shipper's supply. The original is given to the shipper as a receipt and the duplicate is sent to the office, daily. From this the shippers' ledger is posted. This report should show the shipper's number, date, pounds received and disposition, either to pasteurizing or separating departments. Milk is usually converted from a poundage basis to gallons after leaving the receiving department, and the conversion is made on the basis of 8.6 pounds to the gallon.

The total milk receipts should be reconciled daily with reports of milk utilized in the various departments, on the basis of butterfat content, and the shrinkage should be ascertained, both in pounds (butterfat) and percentage. In most plants this shrinkage should never exceed 3 per cent. This reconciliation must be made in order to account for the disposal of all milk received at the plant.

Pounds of butterfat are computed by multiplying the pounds of milk received by the average daily test, e.g.—50,000 lbs. received, average test 4.4 per cent. butterfat (B.F.) in pounds equals 50,000 times 4.4 or 2,200 lbs. Thus, if the milk actually utilized in the plant for the day was 2,145 lbs. (B.F.), the shrinkage was 55 lbs. or 2.5 per cent.

PROCESSING

Processing includes the following operations:

1—Filtration
2—Pasteurization
3—Standàrdization
4—Separation
5—Washing
6—Filling
7—Cooling

Upon leaving the receiving room the milk is carried by sanitary pipes to a preheater, which heats the milk to 110°. From this heater it flows into a filter, where dirt and other foreign substances are removed. The preheating is necessary in order to make the milk flow freely, since cool milk will not filter properly.

The milk flows from the filter into the pasteurizing vats (usually 300-gallon capacity) for pasteurization. Pasteurization consists of heating the milk to a temperature from 142° F. to 145° F. for thirty (30) minutes and then cooling rapidly to 40° F. by passing over brine pipes in a stainless steel cooler. The brine temperature is kept at 10° above zero F. and the milk enters at the top at a high temperature, reaching the bottom at 38° to 40° F.

While in the pasteurizing vat, the milk is standardized; that is, if the milk to be bottled or otherwise disposed of is to test 5 per cent., enough cream is added to bring the whole quantity up to the test required.

After being pasteurized, the milk is transferred at accumulated cost either to the bottle filler or to the separators.

In the separating department, centrifugal machines separate the milk, so that less than .01 per cent. of fat remains in the skimmed milk. The cream realized from the separation of milk from the pasteurizing department or from returned milk is standardized to various grades in whatever quantities are required for sale to customers, and that part is immediately transferred to the cold room for distribution, while the remainder is transferred to vats preparatory to churning. The cost of separating is partly compensated by the value of the skimmed milk utilized in the manufacture of buttermilk and cottage cheese. The skimmed milk value is computed on an arbitrary basis, usually 20 per cent. of the cost of the whole milk at the separator.

The pasteurized milk necessary to meeting the bottling requirements is transferred to the filling department (at accumulated cost), where it is bottled and capped by automatic machinery at the rate of 70 pints or 50 quarts a minute. The milk is then taken by conveyors to the cold room for distribution to customers.

Empty bottles and cases are carefully washed and sterilized. Bottle-washing machines wash and sterilize approximately 800 bottles at once. Sixteen minutes are required for proper sterilization. The clean bottles travel by conveyor (untouched by hands) to the filler machines. Careful inspection is made of clean bottles on the conveyor line to remove any chipped or broken bottles.

COST OF PRODUCTS

Each department should make out a daily report showing opening inventory, receipts, transfers and closing inventories. This information is assembled by a clerk, who accumulates the data on summary sheets for the purpose of showing monthly costs. These reports, etc., should be kept in pounds (and gallons if desired), and the money value should be computed at the end of the month.

The finished cost of milk in the cold room consists of the cost of raw product (which in the milk industry constitutes the greater portion of the finished product cost), with processing costs assembled from the departmental expense accounts and allocated monthly to the various departments. The expenses should be gathered in cumulative form, so that it will be necessary to distribute only monthly totals.

There are many methods of distributing overhead or departmental expenses, but probably the most troublesome of all is the method used in distributing steam, refrigeration, water and heat, which is best accomplished by means of standards ascertained by each company for its own use.

Expenses applicable to departments should be prorated to the products which pass through any particular department, on the basis of units handled in that department. As a product is transferred from one department to another, the cost as accumulated in the previous department should be carried over to the succeeding department, so that the cost at each step of production may be known and the loss occasioned by reason of the transfer from one department to the other should be placed upon the department relieved, as for example:

	Gallons	Unit cost	Product cost
Milk transferred from pasteurizing department...	50,000	$.300	15,000
Total shown by filler reports....................	49,500	.323	15,000
Shrinkage..............................	500		

The shrinkage of 500 gallons (1%) is absorbed in the product cost, 49,500 gallons divided into the accumulated cost of $15,000 or a unit cost of $0.323 per gallon, instead of $0.30, carried over from the previous department. To this product cost would be added washing, filling and cold room expense as allocated on some "unit" method of allocation, such as cans, cases, boxes, etc.

MANUFACTURING

In the manufacture of buttermilk and cottage cheese, there is the cost of the skimmed or raw milk transferred, to which is added the respective departmental expenses; and in the case of cottage cheese, there are container and packing expenses.

BUTTER MAKING

All cream received should be weighed and sampled for butterfat content, for the purpose of determining proper payment, where cream is received from the shipper, or for purposes of credit to other departments, when products are transferred to the butter department. After being pasteurized the cream is pumped into vats for "ripening." These vats should be measured for volume of cream and tested by composite sample to determine the butter-fat content. This is necessary in determining churn over-run. From plant report summary and cost sheets the churn-room report would be approximately as follows:

(Figures not actual)	Cream gallons	Pounds B.F.	Unit cost	Cost value
Cream purchased	3,400	9,500	$.30	2,850
Surplus cream	1,300	4,500	.30	1,350
Cream dumped	500	1,400	.30	420
Total to churns	5,200	15,400		4,620
Add—over-run—20%		3,080		
Churn-room expenses				115
Total to packing room		18,480	$.256	4,735
Less—print loss—2%		370		
Butter packed		18,110	$.261	4,735
Add—packing expense				300
Cold-room expense—pro-rata				15
Cost of butter packed		18,110	$.278	5,050

RETURNED AND SURPLUS PRODUCTS

Milk dealers make a constant effort to reduce the loss due to returned products, which seem to be a necessary evil, and such losses must be carefully and thoroughly checked, to guard against increased losses through collusion of employees.

Distributors of fluid milk and cream are burdened with the problem of an over-supply of milk in the months of high production, because sufficient milk must be assured to meet consumer demands in the season of low production. This surplus milk must either be sold in bulk at any price obtainable or be manufactured into by-products. The surplus product, if costed at average cost value, will be burdened with an inflated cost, and it is better to cost it at an equivalent of the prevailing market price. The difference between actual cost and the surplus raw product value represents surplus product loss, which should be allocated to fluid-milk cost on a basis of fluid-milk-product sales.

PRODUCT COST STATEMENT

The product-cost statement should be prepared to show, in analytical form, the actual cost and profit or loss for each product handled, according to size of package and whether sold at retail or wholesale. When prepared on the basis of sales units or points (variously established), the statement may be made to show unit cost and profit or loss according to products for statistical and managerial purposes.

COLD-ROOM AND LOAD OUT REPORTS

Finished products in cold room are the equivalent of unconverted cash and must be protected against theft and errors in reporting. If practicable, a storekeeper should be put in charge of the cold room to check carefully all goods in and out of the room. All removals should be on the basis of requisitions showing disposition to retail routes, wholesale routes, special deliveries and retail stores or selling stations. Receipts and disbursements of the cold room should be summarized on a daily cold-room report. This report shows an opening inventory by actual count (a.m.) to which all receipts properly classified are added. From this total charge are deducted all requisitions for withdrawals, extras to routes and stores, transfers, breakage, etc., resulting in a "balance to be accounted for (p.m.)." Here the report should provide for another actual count, say at 7 p.m. in order definitely to place responsibilities for shortages on the day or night attendant.

At this point the route "load out" reports are summarized and deducted from the "balance to be accounted for (p.m.)," which leaves a balance on hand to be verified by an actual (a.m.) count, all "overs" and "short" to be noted at the bottom of the cold-room report. The overage or shortage of each product should be carefully checked daily by some responsible person. The daily variations should be summarized and careful comparisons made monthly, from which standard losses may eventually be established.

The accuracy of the "load out" summaries should be closely watched, as these reports are sometimes made to cover up discrepancies of route men and others.

ROUTE ACCOUNTS

The territory served by the dairy is subdivided into routes, and each route is served by a delivery crew consisting of a driver and a helper. Route service is supplemented by special delivery service, which takes care of orders requiring immediate delivery.

Route accounts are handled differently from customers' accounts in most industries. The number of customers served sometimes runs into thousands even in a medium-sized business. A greater part of the work of keeping customers' accounts falls on the delivery men or route men. Route sheets are made up the first of each month and are arranged in order of delivery when turned over to the route men. These sheets show unit sales of products by days and the record of sales is entered when the delivery is made.

Different colored sheets are used for cash and credit customers.

The route men are charged at sales price with all products taken out, according to a loading requisition and "load out" sheets, and also for extras. Credit is given for products returned, as per "return" slips and the wholesale or other discounts and the result is the net total daily sales. Settlement should be made daily for the net total sales, after deducting for "charge" sales made, bottles purchased, coupons, etc., and after adding collections made on charge accounts. In this manner control is maintained over the driver's balances. The route books are compared at regular intervals with the current balances outstanding as shown by the office accounts or route men's settlement sheets.

The settlement sheets should provide space for reconciling bottles, cans, etc., in service. These sheets are checked by the cashiers and recapitulations are made, by clerks, on a route sales sheet providing for a full month's sales. The same sheets are also summarized to show daily sales in quantities and amounts, by products, according to size of container.

PATRON'S SETTLEMENT SHEET

The patron's settlement sheet is peculiar to the industry and needs some explanation. It sets up in convenient form, the daily weights of milk furnished by patrons, also the pounds of butterfat of cream purchased, as cream is usually paid for on the day following receipt. It shows the total value of milk purchases for the month and also the deductions for advances, supplies furnished, dairy products taken for own use, and sometimes for association expenses, if included in the purchasing agreement.

Milk is usually purchased on the basis of a certain fixed daily or monthly maximum, and any milk in excess is paid for as surplus milk, at a different base price, according to the then prevailing buying plan, and the patron's sheets should provide space for separate computation of "regular" and "surplus" requirements. At the end of the month or other pay period, the sheets are computed and cheques for undrawn balances are mailed to patrons.

BOTTLE LOSS

Many methods are used to account for bottles. Sometimes they are classified physically, as current assets, sometimes as fixed assets, and at other times are written off as expense, when put into service.

The best method probably is to set up the bottles in service by actual inventory of filled and empty bottles in use and to make an estimate of bottles out on routes, i.e., two, three or more to each customer, based on two times the average daily sales units. The total bottles in service, thus computed, should be valued at, say, one-half the original cost per unit, and would be shown as a current asset in the balance-sheet. New bottles should be charged to manufacturing and operating supplies, when purchased, and credited thereto when put into actual use and charged to "bottles in service." At the end of the month, or other period, a new inventory of bottles in service should be taken, in the manner described above, and the difference between the new inventory and the debit balance in bottles-in-service account should be charged to bottle loss, which is a profit-and-loss account. Milk cans and bottle cases should be classified as fixed assets and valued at cost less 40 per cent. or 50 per cent.

Other inventories do not present any special problems of valuation not found in other industries.

PROPERTY, PLANT AND EQUIPMENT

Fixed assets, particularly buildings and machinery, present somewhat of a problem. Buildings are usually of a special type, which can not readily be converted to other purposes, and this should be taken into consideration in setting salvage values and in establishing depreciation rates. The machinery and equipment accounts present the problem of numerous kinds of special items, most of which have a different useful life, for which a composite rate can not be used in setting up depreciation reserves.

The rates of depreciation usually applicable to the different types of machines and equipment are too varied to describe here. The rates can best be established by experience, but suggested uniform rates have been formulated by milk dealers associations and by the bureau of internal revenue.

A recent treasury decision, 4422, February 28, 1934, makes it mandatory to classify fixed assets according to length of life, in order that the taxpayer may be able to substantiate for federal income-tax returns the rates of depreciation used.

RESALE VALUE OF ROUTES

Competition in the acquisition of routes and customers has brought about a condition that requires comment. Dairy customers are often acquired by purchase from other dealers, by campaigns of direct solicitation, and sometimes by payment of a "premium" to the customer for his trade. This cost of acquiring trade is usually charged to an account called resale value of routes. This account is almost in the same category as goodwill, and it is very difficult to place a value on it for balance-sheet purposes. The proper valuation would be cost outlay, reduced periodically for loss of customers, but the time involved makes it difficult for an accountant to make any verification.

BALANCE-SHEETS

Balance-sheet items requiring special comment have already been mentioned. A study of balance-sheets and operating statements of dairies and milk dealers will reveal that there is a very rapid turnover, due to the more or less perishable nature of the products handled. For this reason, a large current ratio is not necessary; a ratio of slightly in excess of one to one is considered sufficient. A condensed pro-forma balance-sheet follows:

BLANK CREAMERY & DAIRY COMPANY

Balance-sheet—August 31, 193—

Assets

Current assets:		
Cash in banks and on hand		$ xxxx
Customers' notes receivable (less reserve $xxxx)		xxxx
Customers' accounts receivable:		
Route accounts—drivers	$ xxxx	
Retail accounts—office	xxxx	
Wholesale accounts—office	xxxx	
	$ xxxx	
Less—reserve for doubtful	xx	xxxx

Inventories:		
Finished products, milk, cream, cheese, etc.—at cost	$ xxxx	
Bottles in service—at cost less 50%	xxxx	
Operating supplies—at cost	xxx	xxxx
Total current assets		$ xxxxx
Prepaid insurance, interest, stationery, etc.		xxx
Real estate—not used for plant purposes		xxxx
Property, plant and equipment—at cost:		
Land	$ xxx	
Buildings	xxx	
Machinery and equipment	xxx	
Cans and cases in service	xxx	
Office furniture and fixtures	xxx	
Delivery equipment	xxx	
	$ xxxxx	
Less—reserve for depreciation	xxxx	xxxxx
Resale value of routes (state basis)		xxx
Total		$xxxxxx

Liabilities

Current liabilities:		
Notes payable—banks		$ xxxx
Notes payable—machinery		xxxx
Accounts payable—trade		xxxx
Accounts payable—patrons for milk and cream		xxx
Outstanding milk tickets, and store bottles		xxxx
Accrued liabilities		xxxx
Provision for federal taxes		xxxx
Total current liabilities		$xxxxxx
Capital stock—common:		
Authorized 1,000 shares of $xxxx each		
Whereof outstanding 750 shares	$xxxxxx	
Earned surplus	xxxxx	xxxxxx
Contingent liabilities reported—(state nature and amount)	$xxxxxx	
Total		$xxxxxx

OPERATING STATEMENTS

The detail of operations to be presented depends entirely upon conditions and the scope of the examination. It is unnecessary to repeat statements of details of operations and relative statistical data, if already prepared by the company's accounting department. A condensed profit-and-loss account, supplemented by a schedule of departmental expenses, follows:

BLANK CREAMERY & DAIRY COMPANY

Condensed profit-and-loss account for the year ended August 31, 193—

Sales:			
Retail sales			$ xxxxx
Wholesale sales			xxxxx
Total gross sales			$ xxxxxx
Less—sales discounts and allowances			xxxx
Net sales to customers			$ xxxxxx
Cost of sales:			
Cost of production:			
Purchases of raw product		$ xxxxx	
Purchasing expenses		xxxx	
Cost of raw materials		$ xxxxx	
Processing expenses		xxxx	
Manufacturing expenses		xxxxx	
Total cost of production		$xxxxxx	
Add—purchases of finished products		xxxxx	
		$xxxxxx	
Deduct—inventory increase:			
Finished products—August 31, 193—	$xxxx		
Finished products—August 31, 193—	xxxx	xxxxx	
Cost of sales			xxxxxx
Gross margin (or loss) on sales			$xxxxxxx
Operating expenses:			
Selling expenses		$ xxxxx	
Administration and general expenses		xxxxx	xxxxx
Net operating profit (or loss)			$xxxxxxx
Miscellaneous income:			
Interest earned—etc.			xxxx
			$xxxxxxx
Miscellaneous charges:			
Interest paid		$ xxxxx	
Loss on capital assets sold		xxx	xxxxx
			$ xxxxxx
Provision for federal taxes			xxxx
Net income (or loss)			$ xxxxxx

BLANK CREAMERY & DAIRY COMPANY

Statement of departmental expenses for the year ended August 31, 193—

Purchasing expenses:		
Country buying expenses		$ xxxxx
Transportation		xxxxxx
Receiving labor		xxxxx
Laboratory expense		xxxx
Total purchasing expenses		$ xxxxxx
Processing expenses: (detail by processes)		
Pasteurizing expenses	$xxxx	
Standardizing expenses	xxxx	
Separating expenses	xxx	
Washing bottles, cans, etc.	xxxx	
Filler-room expenses	xxxx	
Cold-room expenses	xxxx	
Total processing expenses		xxxxxx
Manufacturing expenses: (detail by kinds)		
Butter expenses	$xxxx	
Butter packing	xxx	
Buttermilk expenses	xxxx	
Cottage cheese	xxxx	
Total manufacturing expenses		xxxxxxx

Statistical data:

	Unit cost	Unit
Kind of expense:		
Purchasing	$xxxxx	Gallons purchased
Pasteurization	xxxxx	Gallons pasteurized
Separating	xxxxx	Gallons separated
Washing	xxxx	Bottles or cans
Filler room	xxxx	Bottles or cans
Cold room	xxxx	Cases, boxes, cans
Butter manufacturing	xxxx	Pounds
Butter packing	xxxx	Pounds
Buttermilk manufacturing	xxxx	Gallons
Cottage cheese	xxxx	Pounds

Selling and administration and general expenses are similar in classification to those of other industries and no schedules are considered necessary. Selling and administration expense statistics are computed to fractional cents per point. The point basis is usually established by starting with one quart of milk equalling one point, and other products are converted to points, their unit value depending on their cost and sales value as well as the length of time necessary to complete the delivery to customers.

Legal Notes

Harold Dudley Greeley, *Editor*

SUBROGATION OF INSURER ON SURETY BOND

A recent decision by the supreme court of Florida (*Dantzler Lumber & Export Co. et al.* v. *Columbia Casualty Co.*, 156 Southern Reporter 116) raises several questions of interest to practising accountants. All the following statements are allegations made by the plaintiff, the Columbia Casualty Company; none of them has yet been proved as true, but all were assumed by the court to be true for the sole purpose of deciding whether or not plaintiff had stated a cause of action.

The Dantzler Company was engaged in the lumber business at Tampa, Florida. The Columbia Casualty Company insured the Dantzler Company against embezzlements by certain of its employees, by a surety bond in the sum of $10,000. One of those employees was the bookkeeper of the Dantzler Company and he succeeded in embezzling $39,425.61, of which $1,670.09 was taken in 1927, $4,716.62 in 1928, $15,670.70 in 1929, $8,693.20 in 1930, and $8,675 in 1931.

During all of these years the books and accounts of the Dantzler Company were being audited by a firm of public accountants. It was alleged that the auditors were unrestricted as to the scope of their work and that they were required to make complete and detailed audits, including the examination of all cash transactions. The auditors certified in each of their reports for the years 1927 to 1930 inclusive that "all record cash receipts for the year under review were traced directly into the bank deposits and disbursements through the bank account were verified by an examination of said cheques, invoices or other supporting data on file." The defalcations were accomplished by means of cheques made payable, in effect, to bearer and it was alleged that if the auditors in 1927 had compared the cheques with invoices and other supporting data, the theft would have been discovered, the bookkeeper discharged, and the subsequent thefts, amounting to $37,755.52, prevented.

The Columbia Casualty Company paid the full penalty of its bond, $10,000 to the Dantzler Company. At that time it notified the Dantzler Company and the auditors that the Columbia Casualty Company would make a claim against the auditors for reimbursement of its loss, on the theory that it was subrogated to the rights of the Dantzler Company against the auditors, and it warned the Dantzler Company and the auditors not to make any settlement between themselves without providing for the reimbursement of the Columbia Casualty Company. It was alleged that notwithstanding this warning, the Dantzler Company and the auditors did make a settlement between themselves for an amount not disclosed to the Columbia Casualty Company.

Thereupon the Columbia Casualty Company brought an action against the Dantzler Company and the auditors seeking to ascertain whether or not a settlement had been made and if so for what amount, and for a decree by the court that the Columbia Casualty Company be subrogated to the rights of the Dantzler Company against the auditors and that the auditors be compelled to pay the casualty company such amount as might be found due. The defendants in the court in which the action was started asked that the action be dismissed on the ground that the allegations did not state a cause of action. That court refused to dismiss it and an appeal was taken to the supreme court of Florida. The supreme court sustained the court below and consequently the case will be tried unless some settlement is made out of court. Of the five judges of the supreme court, one dissented in part and another dissented wholly from the court's decision.

Two principal questions were submitted to the supreme court, of which the first was whether or not the allegations made by the plaintiff set forth facts sufficient to show liability on the part of the auditors to the Dantzler Company. If that question were answered in the negative, plaintiff's case would fail, but if it were answered affirmatively, then the second question would be considered: Should the casualty company be subrogated to the Dantzler Company's rights against the auditors? If this second question were answered in the negative, plaintiff's case would fail; if in the affirmative, the case should be tried and the amount of the auditors' liability determined.

The court answered the first question in the affirmative, stating that the allegations presented a case of gross negligence if not of legal fraud on the part of the auditors. "Public accountants and auditors hold themselves out to be skilled and competent to perform the duties and services which they undertake to perform as accountants and auditors, and they are bound in law to perform such services in an accurate and skillful manner . . . they occupy a relation of trust and confidence to their employer based upon the superior knowledge of the business of accounting and auditing possessed by the auditors and accountants." Doubtless no accountant will disagree with the court's conclusion in that statement, however much some would prefer to have the practice of accountancy described as a profession rather than as a business. Neither of the dissenting judges disagreed with this part of the decision. Their disagreement was on the matter of subrogation.

The first point of legal difficulty arose in determining whether the Dantzler Company's right against the auditors was to sue for breach of contract or for damages in a tort action for negligence. The court held that the right of action would be one in tort for negligence, although an action could be brought also for breach of contract. "The action here is not for mere non-performance, but it is based upon an alleged breach of duty to skillfully perform and truly report the condition of the accounts." The court quoted from *Smith et al.* v. *London Assurance Corporation*, 109 App. Div. 882, 96 N. Y. S. 820: "Where public accountants were employed on the express agreement that they should frequently check the defendant's cash account . . . and they negligently and willfully failed to do so, and on account of such failure its cashier was enabled to embezzle large amounts of money, they were liable for the sums embezzled." In other words, the contract merely created the conditions which made the tort of negligent performance possible, and notwithstanding the technical breach of contract, an action in tort for damages due to negligence could be maintained. This is a point of importance to accountants where the fee is small and the loss from defalcation large, and the accountants claim that the client's remedy is limited to a recovery of the fee which constituted the consideration for the contract.

The court having found sufficient allegations to justify a trial on the issue of negligence, then turned to the second question and decided that the casualty company was subrogated to the rights of the Dantzler Company against the auditors. The doctrine of subrogation is a creature of courts of equity, its purpose being the doing of complete justice among all the parties, without regard to form. It rests upon the maxim that one person should not be enriched at the expense of another. The court quoted from 25 *Ruling Case Law 1372:* "One who has indemnified another in pursuance of his obligation so to do succeeds to, and is entitled to, a cession of all the means of redress held by the party indemnified against the party who has occasioned the loss . . . this right of the insurer against such other person not resting upon any relation of contract or of privity between them."

The judge who dissented wholly from the court's decision stated in his opinion that he saw no right to subrogation in this case. He admitted that the casualty company would be subrogated to any rights which the Dantzler Company might have against the defaulter, but he would not allow it to be subrogated to such rights against the auditors. He based this position chiefly on the ground that there was no direct relationship between the contract of suretyship and the contract between the Dantzler Company and its auditors. The Dantzler Company was under no obligation to employ auditors, the contract made with its auditors was for its own benefit and not for the benefit of the casualty company, and the casualty company neither knew of the auditing contract nor relied upon it in issuing its surety bond. "So far as the casualty company is concerned, its liability and its loss would have been the same if the Dantzler Company had never made a contract with (the auditors) and had never had its books audited." That statement, unfortunately, is true so far as the audit in this alleged situation is concerned. Also, he objected to subrogation on the further ground that it would deprive the auditors of their right to a trial by jury.

On this last point, the court held in effect that there was no right to a trial by jury. The relief which the casualty company was seeking could be obtained only in equity and the "court of equity, having acquired jurisdiction to determine rights cognizable in equity between the parties, it will reach out and draw into its consideration and determination the entire subject-matter, bringing before it all the parties interested therein, and will retain such jurisdiction until all matters involved in litigation between the parties or growing out of and connected with the subject-matter of the suit are fully disposed of."

The chief justice of the court, who concurred in part with the court's decision, dissented from the denial to the auditors of a jury trial. He contended that the auditors were constitutionally entitled to a jury trial and that the casualty company should be compelled, by subrogation, to sue the auditors in a court of law where a jury trial could be obtained.

Students' Department

H. P. Baumann, *Editor*

Ohio C. P. A. Examination

The following question in auditing was set by the Ohio state board of accountancy in the November, 1932, examinations:

Question:

You have been engaged to audit the books of a manufacturing company. (a) Give journal entries and explanations. (b) Write audit report explaining your verification and adjustment of each asset and liability. (c) Prepare balance-sheet as of December 31, 1931, properly classified. You are privileged to make reasonable assumptions whenever necessary, provided notice thereof is contained in your solution.

Petty cash

Cash on hand $195; vouchers duly signed for the following: freight and express $15, office salaries $20, postage $12, unaccounted for $8, counted as of December 31, 1931.

Cash on deposit

Audit commenced January 31, 1932. The bank statement on that date showed a balance of $12,210. Cheques not presented to the bank for payment —No. 210 for $150, No. 212 for $42, and No. 213 for $50. During the period from December 31, 1931, to January 31, 1932, the following transactions occurred:

Total deposits	$ 12,052.50
Bank charges	12.00
Total cheques drawn	7,640.00

Accounts receivable

Debit balances	$189,755.55
Credit balances	2,755.60
The debit balances included the following:	
Officer's personal account	$ 10,000.00
Employees' accounts	3,205.00
Due on stock subscriptions	15,000.00
Consignment accounts (credited to sales at cost)	22,450.00

The allowance for bad accounts has been estimated to be $22,000. Notes receivable were $9,000. Consignee reported no sales to December 31, 1931.

Inventory

Raw materials	$ 28,500.00
Finished goods	68,880.00
Office supplies	2,700.00
Goods in process:	
Material	9,200.00
Labor	4,500.00
Burden 100% of labor	4,500.00

An invoice of $3,300 for materials in transit December 31, 1931, has been included in the accounts payable but not included in the inventory.

Included in sales is $6,000 of finished goods also included in inventory. Billing was dated December 28, 1931.

Machinery and equipment

Factory building and equipment cost $150,000. There has been set up $45,000 depreciation reserve. An appraisal made shows the replacement cost as $220,000 and the depreciated sound value at $180,000.

Separate account called "New factory building" shows $28,000. This building is now being used but you find in the minutes that a contract was given the construction company for $35,000.

Treasury stock

The company acquired January 1, 1931, 200 shares of its own stock for $17,000 and received 8 per cent. dividend declared December 28, 1930, to stockholders of record January 2, 1931.

Insurance

Life insurance on officers of the company—cash surrender value January 1, 1931, $3,220; premium paid December 31, 1931, $780; additional surrender value $300.

Unexpired general insurance $2,850.

Accounts payable and accrued accounts

Trade creditors	$ 48,650.00
Accrued payroll	3,850.00
Taxes—59% federal income	6,684.00
Damage claim—In litigation	2,500.00
Notes receivable discounted	6,000.00
(bank reported $1,500 of these notes paid prior to December 31, 1931)	
Accrued attorney's fees on damage claim	350.00

Bonds payable

Bond issue dated June 1, 1926, $100,000 6 per cent., 20-year, sinking fund established to retire these bonds. Indenture provided that the trustee could purchase these bonds whenever they could be obtained at a price not to exceed 94, and the trustee purchased and retired bonds at a face value of $20,000 at 93 on June 1, 1931.

Capital stock

Outstanding stock $250,000 at $100 par value has been changed to $150,000 7 per cent. preferred $100 par value and 2,000 shares of no par value. The transfer has been made and new stock is outstanding as of December 31, 1931. The transfer was made on the basis of 1½ shares of preferred and 2 shares of no par stock for each 2½ shares of the original issue.

Solution:

(a) Adjusting journal entries
December 31, 1931
(1)

Surplus	$ 55.00	
Petty cash		$ 55.00

To charge surplus account (1931) with the following petty cash expense vouchers carried in the petty cash fund on December 31, 1931:

Freight and express	$ 15.00
Office salaries	20.00
Postage	12.00
Shortage	8.00
Total	$ 55.00

Since the audit commenced on January 31, 1932, it is assumed that it was not possible to supervise the mailing of statements to customers as of December 31, 1931, for purposes of confirmation. Also, since the petty cash was counted as of December 31, 1931, it is assumed that the notes receivable on hand were examined and listed at the same time.

(2)

Due from officer	$ 10,000.00	
Due from employees	3,205.00	
Stock subscriptions receivable	15,000.00	
Consignments out	22,450.00	
Accounts receivable		$ 47,899.40
Customers' credit balances		2,755.60

To segregate amounts due from officer and employees; from stockholders for stock subscriptions; and to set up as an inventory, the cost of goods out on consignment as December 31, 1931.

It is assumed that the unpaid stock subscriptions do not represent old, uncalled (and-not-likely-to-be-called) balances, but amounts not yet due on subscriptions, since the problem indicates that the old outstanding stock of $250,000 (which was exchanged for new preferred and common) was the total authorized.

As the problem specifies certain items which were included in the debit balances of accounts receivable without including the notes receivable of $9,000 mentioned later, it must be assumed that the notes were carried in a separate account.

(3)

Surplus	$ 22,000.00	
Reserve for bad debts		$ 22,000.00

To provide a reserve for the estimated loss on uncollectible accounts as at December 31, 1931.

(4)

Materials in transit	3,300.00	
Surplus		3,300.00

To record the inventory of materials in transit as at December 31, 1931. The invoice for these materials has been included in the accounts payable.

(5)

Surplus	6,000.00	
Inventory of finished goods		6,000.00

To eliminate from the inventory of finished goods at December 31, 1931, the merchandise sold on December 28, 1931.

It is assumed that the title to these goods actually passed on December 28, 1931 (the billing date), and that the inventory valuation was found to be $6,000. If, however, title had not passed, and the billing price was $6,000, the correcting entry should be:

Surplus	$6,000.00	
Accounts receivable		$ 6,000.00

To reverse the sale incorrectly recorded on December 28, 1931.

(6)

New factory building	$ 7,000.00	
Construction Company		$ 7,000.00
To record the liability for the balance due on the contract to construct the new factory building. The total cost is $35,000 of which only $28,000 has been recorded.		

(7)

Surplus	1,600.00	
Treasury stock		1,600.00
To reduce the cost of the treasury stock (200 shares, par value $100 per share) purchased on January 1, 1931, for $17,000 by the amount of the dividend received (8% of $20,000).		

The Ohio statutes provide, generally, that the "purchases of a corporation's own shares must be made out of surplus." As the purchase price of $17,000 included the right to the dividend of 8 per cent. declared on December 28, 1930, the cost of the stock should be considered as $15,400 ($17,000–$1,600).

(8)

Cash surrender value of life insurance	$ 300.00	
Unexpired insurance	3,330.00	
Surplus		$ 3,630.00
To record increase in cash surrender value of life insurance (assuming that premium was charged to expense); and to set up prepaid insurance, as follows:		

General insurance		$2,850.00
Life insurance:		
Premium paid Dec. 31	$780.00	
Less: increase in cash value	300.00	
Expense—all prepaid at Dec. 31		480.00
Total		$3,330.00

(9)

Notes receivable discounted	1,500.00	
Notes receivable		1,500.00
To reverse discounted notes paid by makers prior to December 31.		

(10)

Surplus	400.00	
Accrued bond interest		400.00
To accrue one month's interest on $80,000 of 6% bonds (on the assumption that interest is payable semi-annually on June 1 and December 1).		

(11)

Capital stock	$250,000.00	
7% preferred stock		$150,000.00
Common stock—no-par value		100,000.00
To record change of capitalization—1½ shares of preferred and 2 shares of no-par stock issued for each 2½ shares of common.		

No entry is required for the exchange of the 200 shares of old stock in the treasury for new stock (120 shares preferred, 160 shares common).

The foregoing adjustments would require an adjustment of the accrual made by the company for 1931 income taxes; however, the amount of this required adjustment can not be determined, since we do not know (for example) whether the company files on the reserve basis with regard to bad debts, nor do we know what portion of the $22,000 bad debt adjustment applies to the year 1931.

Working papers for preparation of balance-sheet

The December 31, 1931, balances entered in the following working papers are stated in the problem, with the exception of the following items, which are computed below:

Cash on deposit:		
Bank balance, January 31, 1932		$ 12,210.00
Deduct cheques outstanding:		
210	$ 150.00	
212	42.00	
213	50.00	242.00
Book balance, January 31, 1932		$ 11,968.00
Add:		
Total cheques drawn, January		7,640.00
Bank charges, January		12.00
Total		$ 19,620.00
Deduct: total deposits, January		12,052.50
Book balance, December 31, 1931		$ 7,567.50
Accounts receivable:		
Debit balances		$189,755.55
Credit balances		2,755.60
Control		$186,999.95
Goods in process inventory:		
Material	$ 9,200.00	
Labor	4,500.00	
Burden—100% of labor	4,500.00	
Total		$ 18,200.00

Sinking fund assets:

On June 1, 1931, the sinking-fund trustee expended $18,600 for the acquisition and retirement of bonds. While the basis of contributions to the fund is not stated, the situation clearly calls for some assumption of facts; and, since these are 20-year bonds in the original amount of $100,000, it is assumed in this solution that annual deposits of $5,000 were made, beginning June 1, 1927, and all question of interest is disregarded.

Total deposits to December 31, 1931......	$ 25,000.00
Cost of bonds acquired..................	18,600.00
Balance, December 31, 1931.............	$ 6,400.00

Surplus:

Surplus is inserted in the trial balance as the balancing figure.

(b) In requiring an audit report "explaining your verification and adjustment of each asset and liability," the examiners evidently had in mind the "balance-sheet comments" section of an audit report. The remaining sections of the typical report—those dealing with a comparison of financial condition and working capital position, trend of operations, application of funds, etc.—can not be prepared from the data given. With this explanation, the following should meet the requirements of part (b):

Board of Directors, X Company.

Gentlemen: We have made an examination of the accounts and records of X Company for the year ended December 31, 1931. We submit herewith our report, consisting of comments and the following described exhibits and schedules:

Exhibit A—Balance-sheet, December 31, 1931
Exhibit B—Analysis of surplus, for the year ended December 31, 1931 (not submitted)
Exhibit C—etc.

Balance-sheet comments

Cash on deposit—$7,567.50

The cash on deposit was verified by reconciliation of the bank account, supplemented by a confirmation from the depositary. The bank account was also reconciled as of January 31, 1932 (the date of commencing the audit), and intervening transactions were examined.

Petty cash—$195.00

The petty cash was verified by actual count on December 31, 1931.

Notes receivable—$3,000.00

This amount represents the face value of customers' notes received, less notes discounted, as shown by the following schedule (in which the maturity of the notes is also indicated):

Maturity	Total	Discounted	On hand
January, 1932....................	$	$	$
Etc............................			
Total.........................	$7,500.00	$4,500.00	$3,000.00

X COMPANY

Balance-sheet working papers—December 31, 1931

	Reconstructed trial balance December 31, 1931		Adjustments				Balance-sheet	
Petty cash	$ 250.00				$ 55.00	(1)	$ 195.00	
Cash on deposit	7,567.50						7,567.50	
Accounts receivable	186,999.95				47,899.40	(2)	139,100.55	
Notes receivable	9,000.00				1,500.00	(9)	7,500.00	
Inventories:								
Raw materials	28,500.00						28,500.00	
Finished goods	68,880.00				6,000.00	(5)	62,880.00	
Office supplies	2,700.00						2,700.00	
Goods in process	18,200.00						18,200.00	
Factory building and equipment	150,000.00						150,000.00	
Reserve for depreciation		$ 45,000.00						$ 45,000.00
New factory building	28,000.00		$ 7,000.00	(6)			35,000.00	
Treasury stock	17,000.00				1,600.00	(7)	15,400.00	
Cash surrender value of life insurance	3,220.00		300.00	(8)			3,520.00	
Trade creditors		48,650.00						48,650.00
Accrued pay roll		3,850.00						3,850.00
Accrued taxes		6,684.00						6,684.00
Damage claim		2,500.00						2,500.00
Notes receivable discounted		6,000.00	1,500.00	(9)				4,500.00
Accrued attorney's fees		350.00						350.00
Bonds payable		80,000.00						80,000.00
Sinking fund assets	6,400.00						6,400.00	
Capital stock		250,000.00	250,000.00	(11)				
			55.00	(1)				
			22,000.00	(3)	3,300.00	(4)		
Surplus		83,683.45	6,000.00	(5)	3,630.00	(8)		60,558.45
			1,600.00	(7)				
			400.00	(10)				
	$526,717.45	$526,717.45						
Due from officer			10,000.00	(2)			10,000.00	
Due from employees			3,205.00	(2)			3,205.00	
Stock subscriptions receivable			15,000.00	(2)			15,000.00	
Consignments out			22,450.00	(2)			22,450.00	
Customers' credit balances					2,755.60	(2)		2,755.60
Reserve for bad debts					22,000.00	(3)		22,000.00
Materials in transit			3,300.00	(4)			3,300.00	
Constructive Company					7,000.00	(6)		7,000.00
Unexpired insurance			3,330.00	(8)			3,330.00	
Accrued bond interest					400.00	(10)		400.00
7% preferred stock					150,000.00	(11)		150,000.00
Common stock—no par value					100,000.00	(11)		100,000.00
			$346,140.00		$346,140.00		$534,248.05	$534,248.05

X COMPANY

(c) Balance-sheet—December 31, 1931

Assets

Current assets:			
Cash on deposit		$ 7,567.50	
Petty cash		195.00	
Notes receivable		3,000.00	
Accounts receivable—trade	$139,100.55		
Less: reserves for bad debts	22,000.00	117,100.55	
Inventories:			
Finished goods:			
On hand	$ 62,880.00		
On consignment	22,450.00		
Goods in process	18,200.00		
Raw materials:			
On hand	28,500.00		
In transit	3,300.00	135,330.00	$263,193.05
Sinking-fund assets			6,400.00
Other assets:			
Cash surrender value of life insurance		$ 3,520.00	
Due from officer		10,000.00	
Due from employees		3,205.00	
Stock subscription receivable		15,000.00	31,725.00
Prepaid expenses:			
Office supplies inventory		$ 2,700.00	
Unexpired insurance		3,330.00	6,030.00
Fixed assets:			
New factory building		$ 35,000.00	
Factory building and equipment (appraisal made by . . . Company as of December 31, 1931, indicates a replacement cost of $220,000 and a depreciated sound value of $180,000):			
Cost	$150,000.00		
Reserve for depreciation	45,000.00	105,000.00	140,000.00
			$447,348.05

Liabilities and net worth

Current liabilities:		
Trade creditors	$ 48,650.00	
Construction company	7,000.00	
Accrued payrolls	3,850.00	
Accrued federal income and other taxes	6,684.00	
Damage claim in litigation	2,500.00	
Accrued attorney's fees thereon	350.00	
Accrued bond interest	400.00	
Customers' credit balances	2,755.60	$ 72,189.60
Bonds payable, sinking fund, 6%, due June 1, 1945		80,000.00
Net worth:		
7% Preferred stock—$100 par value:		
Authorized and issued 1,500 shares	$150,000.00	
Common stock—no par value:		
Authorized and issued 2,000 shares	100,000.00	
Surplus ($15,400 restricted by reason of purchase of treasury stock)	60,558.45	
Total	$310,558.45	
Less: treasury stock at cost: Preferred 120 shares, Common 160 shares	15,400.00	
		295,158.45
		$447,348.05

Contingent liability on notes receivable discounted, $4,500

We obtained written confirmations from the payors of all of the above notes.

We examined the $3,000 of notes on hand in conjunction with our count of the cash on December 31, 1931, and we obtained confirmations from the bank with respect to the $4,500 of notes discounted. We determined that all of the notes arose from the ordinary operations of the business.

Accounts receivable—trade—$139,100.55
Reserve for bad debts—$22,000.00

We ascertained that the total of the balances in the individual customers' accounts corresponded with the general ledger controlling account, and that the total of $139,100.55 includes no accounts with officers or employees, and no accounts arising from any other source than the sale of merchandise. We examined the shipping records to see that sales billed represented actual shipments of merchandise.

The following schedule indicates the age of the accounts on December 31, 1931, and the collections thereon to February —, 1932:

Month of billing	Total	Collected to February —, 1932	Uncollected on February —, 1932
Total	$139,100.55	$	$

The greater part of the company's sales are made on terms of 1/10, net 60.

Accounts past due and uncollected on February —, 1932, were reviewed with officials of the company, and the correspondence files and credit information thereon were examined. In our opinion the reserve of $22,000 for bad debts is an adequate provision for normal losses on the collection of these accounts.

Inventories—$135,330.00

The above total may be detailed as follows:

Finished goods:		
On hand	$62,880	
In hands of consignees	22,450	$ 85,330
Goods in process		18,200
Raw materials:		
On hand	$28,500	
In transit	3,300	31,800
Total		$135,330

We satisfied ourselves as to the accuracy and efficiency of the methods followed by the company in listing and pricing the inventory. We made thorough tests of footings and extensions. We checked the inventory sheets against stores ledgers, production orders, and stock records for verification of quantities, prices, and values, and satisfactorily reconciled all material differences. We traced the work in process into the January, 1932, production records, and verified the quantities of some of the larger items of finished goods by count at the time of our audit and examination of the production and shipping records since December 31, 1931.

Raw material prices were determined to be at the lower of cost or market by examination of recent invoices and market quotations. The prices of manufactured goods were verified by examination of the cost system, which was found to be accurate and to be coördinated with the general accounting records.

The receiving records and the voucher register were examined to see that goods purchased prior to December 31, 1931, were included in the purchases and the inventory. Shipping and sales records were examined to see that goods billed to customers were not inventoried. Merchandise out on consignment was verified by a confirmation from the consignee; it is carried in the accounts at cost.

In addition we obtained a certificate from an official of the company to the effect that all quantities were determined by actual count, that all merchandise included was the property of the company, that the inventory was subject to no liens or encumbrances, and that in pricing the inventory due consideration was given to obsolete and defective stock.

Sinking fund assets—$6,400.00

The above amount was verified by a confirmation from the X Bank, sinking-fund trustee. By the terms of the indenture of its bond issue, the company is required to make annual deposits with the trustee sufficient to provide for the retirement of the bonds at maturity (or prior to maturity, whenever bonds can be purchased at 94 or less).

The changes in this account during the year are shown below:

Balance, December 31, 1930	$20,000.00
Deposit, June 1, 1931	5,000.00
Total	$25,000.00
Expended for the purchase of bonds—June 1, 1931: $20,000 at 93	18,600.00
Balance, December 31, 1931	$ 6,400.00

Cash surrender value of life insurance—$3,520.00

We adjusted the cash value for the increase during 1931, as shown by the terms of the policies. We obtained a confirmation from the insurance company stating that the company is the beneficiary under the policies.

Due from officer—$10,000.00

Due from employees—$3,205.00

The above accounts were confirmed by the officer and the employees.

Stock subscriptions receivable—$15,000.00

The subscription agreements were examined, and confirmations of the amounts due were obtained from the individual subscribers.

Office supplies inventory—$2,700.00

We verified the clerical accuracy of the inventory, tested the prices against current invoices, and compared the quantities shown with the quantities on hand at the time of our examination.

Prepaid insurance—$3,330.00

We prepared a schedule of all insurance in force and checked it against the company's insurance register. The above total of $3,330 is properly chargeable to future operations.

New factory building—$35,000.00

This building was constructed and put into use in 1931; no depreciation was taken thereon during the year. The construction contract, in the above amount, was approved by the board of directors of the company.

Factory building and equipment—$150,000.00
Reserve for depreciation—$45,000.00

An analysis of the changes in the above accounts during the year follows:

	Asset	Depreciation reserve
Balances, December 31, 1930	$	$
Additions		
Disposals	*	*
Depreciation for the year		
Balances, December 31, 1931	$150,000.00	$45,000.00

The appraisal of the . . . Company as of December 31, 1931, indicates replacement cost new of $220,000 and a depreciated sound value of $180,000.

We satisfied ourselves that all additions and disposals during the year were authorized and correctly treated in the accounts. We scrutinized the repair and maintenance accounts to determine that no capitalizable items were charged to expense.

Trade creditors—$48,650.00

We ascertained that the total of the open vouchers on December 31, 1931, corresponded with the above total shown by the controlling account at that date. We sent letters to all suppliers with whom the company did business during the past year, with the request that the company's liability on December 31, 1931, be reported directly to us. As of the date of rendering this report, replies had been received confirming $——— of the $48,650 total, with no substantial differences reported.

We examined creditors' statements, the voucher record and check register for January, 1932, and the receiving records both prior and subsequent to December 31, 1931, to determine that all liabilities of the company were reflected by the books on December 31, 1931.

Construction company—$7,000.00

The above amount represents the balance due the construction company under the contract for the construction of the new factory building, as confirmed by that company.

Accrued payroll—$3,850.00

This accrual, computed by the company, was verified by examination of time cards and payroll records for the first week of January, 1932.

Accrued taxes—$6,684.00

This amount may be detailed as follows:

Federal income taxes—1931	$3,944.00
Etc.	
Total	$6,684.00

We verified the accruals set up by the company by examination of prior years' tax bills, current year's returns and assessment rates, and tax laws and regulations.

Damage claim in litigation—$2,500.00

Accrued attorney's fees thereon—$350.00

We are informed by the company's counsel that the maximum liability on the damage claim is $2,500; counsel also confirmed the amount of fees accrued to December 31, 1931.

Accrued bond interest—$400.00

This represents one month's interest on $80,000 of 6 per cent. bonds.

Customers' credit balances—$2,755.60

This amount represents the sum of all credit balances in customers' accounts.

Bonds payable—$80,000.00

We examined a copy of the mortgage and trust deed securing the bond issue, and ascertained that the company is fulfilling the obligations that it assumed thereunder.

We received a certificate from the transfer agent (who is also the sinking-fund trustee) stating that all sinking-fund deposits and interest payments have been made to December 31, 1931. The certificate also stated that $20,000 of bonds had been retired during the year, leaving $80,000 outstanding on December 31, 1931.

7% Preferred stock—$150,000.00

Common stock—no-par value—$100,000.00

The capitalization of the company was changed during the year from $250,000 of $100 par value common stock to $150,000 of 7 per cent. preferred stock of $100 par value and 2,000 shares of no-par value common stock; 1½ shares of preferred and 2 shares of new common were issued for each 2½ shares of the old common.

The 200 shares of old stock acquired for the treasury on January 1, 1931, at a cost of $15,400 were thus converted to 120 shares of preferred and 160 shares of no-par common.

We examined the corporate minutes for the directors' and stockholders' approval of the change in capitalization, and we inspected the authorization from the secretary of state. We ascertained that the treasury stock had been acquired in a manner and for a purpose permitted by statute.

The stock certificate stubs and stock ledger were in agreement with the general ledger as to the number of shares isssued. The shares in the treasury were submitted for our inspection.

Earned surplus—$60,558.45

The changes in earned surplus during the year are detailed in exhibit B. By reason of the acquisition of treasury stock in 1931, $15,400 of this surplus is not available for dividends.

Minutes

The minutes of all directors' and stockholders' meetings during the year were submitted for our inspection, and we found that all action taken therein had been properly reflected in the accounting records.

Book Reviews

ACCOUNTING FOR CORPORATIONS, by RAYMOND L. MANNIX. *Insurance Press, Incorporated,* Boston, Massachusetts. Cloth, 344 pages. 1934.

In *Accounting for Corporations* Professor Mannix offers a text-book presenting the subject as taught at Boston University. There is nothing in it to distinguish it from the large number of similar books already published, save that the provisions of the Massachusetts corporation laws, so far as they affect accounting, are noted and explained. Its field is, therefore, limited, but the book should be helpful to students who intend to take the C. P. A. examinations of that state.

Of the twenty chapters comprising the book, five seem hardly germane to the main subject of corporation accounting, viz.: the first two and the last which deal with more or less elementary definitions and procedure with which students at this stage are presumed or at least ought to be familiar; and the tenth and eleventh on manufacturing accounting which are not peculiar to corporations *per se.*

The other chapters cover the real subject of the book, the accounts peculiar to corporations from their birth to demise, including a timely discussion of reorganizations and their effects upon stockholders and creditors. Proper journal entries and other illustrative statements make clear the concise and very readable text, and the queries and problems at the close of each chapter are ample to test the student. Two appendices contain practice sets for general review.

After "the tumult and the shouting dies," the future reader of this book may reflect with some amazement on the casual remark in the author's description of gold bonds—"the term 'gold bond' at present has lost all of its significance as the United States congress in June, 1933, by a joint resolution abrogated the gold clause in all public and private contracts" (p. 174)—a blunt statement of a fact which undermines the foundation of all business, the sanctity of contracts.

Incidentally, while it does not affect the general purpose of the book, the propriety of the combined closing entries (as illustrated on page 36) may be questioned. The function of the profit-and-loss account in the ledger is to give a bird's-eye view of operations for the period, showing the gross earnings on one side and the costs and expenses, not necessarily in detail but sufficiently classified, on the other. To show only the net profit in that account, as illustrated, makes the account of no value in itself.

As intimated above, Professor Mannix adds nothing new to the subject of corporation accounting, but if his lectures are as concise and lucid as his text-book, the students of Boston University are to be congratulated.

W. H. LAWTON

HIGHER CONTROL, by T. G. ROSE. *Pitman Publishing Corporation,* New York, N. Y. Cloth, 269 pages. 1934.

In *Higher Control* Mr. Rose offers a manual for company directors, secretaries, and accountants of Great Britain, telling what the management ought to know, and what the accountants should provide in the way of monthly statistical reports and graphic charts, in order that prompt and timely action may be taken to extend or contract company operations in accordance with the current trend of its business. As the author claims this is "The first book on . . . higher control" (p. xiii), it is perhaps necessary to see what he means by the term.

"Higher control," he says, "can be defined as a monthly survey of the functional activities of a commercial undertaking, carried out from the business, trading, and financial viewpoints, and based upon direct trend comparison between the position of the moment and the position of the last financial year." (p. 67.)

Throughout the book emphasis is stressed upon frequent—monthly for choice—up-to-date reports and upon the current trend. To ascertain the trend the author proposes what he calls the M. A. T. (moving annual total) method, which is to compare the total for the twelve months to the close of the current month with the total for the last financial year. This method, he claims, "is probably one of the greatest advances that has been made in the technique of administration for many years." (p. 17.) Important if true, but one is moved to ask what logical or significant relation there is between the moving annual total and the actual total for the last year. By "trend" one understands a moving toward or away from a certain standard. Granting that last year's total may be that standard, why would not any arbitrary amount, say a quota fixed for the current year, answer as well? However, perhaps the matter is not vitally important. Any base taken as the standard would suffice as long as the resultant ratios and graphic charts put the management on notice. But I would not like to be the accountant who had to make it clear to a "hard-boiled" director why a 23 per cent. fall in accumulated orders means only a 15 per cent. fall M. A. T., or a 19 per cent. fall in current trend! (See p. 176.)

Nevertheless, A. H. Pollen, an industrial leader, in the foreword informs us that "the system has proved of very patent value in the practical conduct of more than one considerable concern." (p. 1.) This seems to throw some light on the reasons for the steady recovery from the depression in Great Britain—a recovery unhampered by governmental "experiments." Whether this is due to Mr. Rose's ingenious M. A. T. rule or to keeping the management on its toes by more frequent and up-to-date reports is a matter of opinion. American cost accountants have emphasized the importance of the latter for many years.

(Parenthetically Mr. Pollen's bland implication that the "Wall St. debacle" caused the world-wide slump in business is a bit naïve. Would he hold a barometer responsible for an approaching storm?)

W. H. LAWTON

SIMPLIFIED MATHEMATICS FOR ACCOUNTANTS AND EXECUTIVES, by HARRIS D. GRANT, *McGraw Hill Book Co.*, New York. 434 pages. 1934.

When I first had occasion to use mathematics in my practice there had not been published any American books on the subject and one had to depend on the English publications issued by the Institute of Actuaries. A little later

Joseph Hardcastle published in this country his series of articles, now out of print, and—owing, I fear, to the shortsightedness of publishers—never reprinted. All these works began at the beginning; they gave no tables, but they showed how formulæ are built up, and how they are used, and gave examples the most illuminating. Today the student thinks he has no time to spare on such beginnings but demands the results expressed in the form of tables, so that he may quickly reach the end.

To some old fogies this may indicate a lack of thoroughness which, they think, is one of the evils threatening the present day. To the young accountant who does not love mathematics it may bring relief untold, especially if he has ever read any of the final examination papers set by Scottish societies. In my early practice I was often called upon to testify as to the present value of certain lives and was called upon to state, from the witness stand, the somewhat complicated formulæ which were used in the calculations. Such proceedings no longer occur and the courts are prepared to accept the word of a witness as to results obtained from printed tables. And the modern man says "Why not?"

Therefore, under present conditions, such a book as that now before me has increased value and usefulness, and to the modern accountant, the business man and the student, the present volume is a blessing, for its twelve chapters deal with interest problems, instalment sales, average time of payment, annuities, bond valuation, fund amortization, valuing leaseholds, building and loan problems, our old friends the methods of calculating depreciation, and many other matters—all dependent upon mathematics and all clearly set forth. There is also an appendix containing some theory and a number of tables of present values, annuities, etc.

In these days, when a client may telephone asking what rate of interest will be obtained on an issue of serial bonds sold at various prices and will be peeved if one can not instantly give him the answer, this volume may be invaluable; and the student, after telephoning, can if he likes, work the problem with all the formulæ his soul longs for and, if he be lucky, will confirm the reply given over the telephone.

WALTER MUCKLOW

Accounting Questions

[The questions and answers which appear in this section of THE JOURNAL OF ACCOUNTANCY have been received from the bureau of information conducted by the American Institute of Accountants. The questions have been asked and answered by members of the American Institute of Accountants who are practising accountants and are published here for general information. The executive committee of the American Institute of Accountants, in authorizing the publication of this matter, distinctly disclaims any responsibility for the views expressed. The answers given by those who reply are purely personal opinions. They are not in any sense an expression of the Institute nor of any committee of the Institute, but they are of value because they indicate the opinions held by competent members of the profession. The fact that many differences of opinion are expressed indicates the personal nature of the answers. The questions and answers selected for publication are those believed to be of general interest.—EDITOR.]

VERIFICATION OF ACCOUNTS RECEIVABLE

Question: With reference to verification of accounts receivable; what percentage of replies do you think are sufficient to certify to their correctness, where there are three hundred (300) accounts amounting to approximately $75,000?

Answer No. 1: Naturally the complete verification of accounts receivable would involve a 100% reply to the confirmations, with the exception of the accounts upon which payment in full was received between the date of the balance-sheet and the signing of the report. Such a complete response, however, is seldom received and ordinarily accountants will certify by stating the method of verification and indicating the percentage of replies that have been received and the percentage of the amount of the accounts receivable covered by such replies.

While it is true that anything less than 100% verification does not fully satisfy the accountant, yet he recognizes the fact that if the confirmations have been duly delivered to all debtors, indicating therein the amount of their indebtedness as shown by the books, that any debtors who disagree with the amounts shown by the accountants' confirmation form will be sure to reply. He, therefore, considers that he has made a reasonable investigation and is reasonably safe in assuming that such debtors as do not reply accept the amounts stated in the confirmation forms as being correct.

This is predicated on the assumption that the replies that are received confirm the accuracy of the accounts which they represent. If replies indicate many differences resulting in disclosing that the books of the client are not accurate, then the accountant will not feel satisfied until he has received as near a 100% confirmation as it is feasible to achieve. This is usually accomplished by sending out one or more "follow-ups" by registered mail with a return receipt requested.

Answer No. 2: It is not possible in our judgment to make a specific reply as a satisfactory percentage of replies to confirmations on accounts receivable depends on the company's system of internal control, the nature of its business, the probability of replies from the type of customers, the amount in dollars of confirmations returned, the payments by customers subsequent to the date at which the examination is made, etc. In short, the question is one of accounting judgment and experience which can not be answered in general percentages.

Answer No. 3: If the writer intends to certify as to the correctness of the accounts receivable, I do not see how any less than 100% of replies to the request for verification can be considered satisfactory. We do not ordinarily expect to certify to the correctness of customer's accounts, but usually are only interested in knowing that the total of all accounts is substantially correct. It is rarely possible to get more than a two-thirds return from requests for verification, and it is usual in reporting on verifications merely to state the percentage of returns and the results indicated on those replies received.

ACCOUNTING FOR THE EXCHANGE OF MUNICIPAL BONDS

Question: One of our clients operates a quasi-public trust in which is held a considerable quantity of municipal bonds, most of which were purchased several years ago. The bonds of some of these municipal communities have a present market value considerably less than cost and the directors of the company contemplate exchanging some of these bonds for bonds of other municipal units which they feel have a better chance to recover values than those of the communities sold. On these exchanges the actual cash involved will be comparatively small amounts necessary to make up the differences of value in the exchange. Furthermore, no question of income tax liability is involved because the corporation is exempt from income tax.

It is our opinion that in the case of such exchanges it is necessary, from the point of view of proper accounting procedure, to have the books reflect each of these transactions in detail rather than to have the new securities show on the books value equal to the cost of the securities which were exchanged, subject to whatever cash adjustment there may be. The directors of the company feel that the latter procedure is permissible.

Answer No. 1: We wish to advise you that we agree with the person who made the inquiry that in the case of such exchanges it is necessary to treat the respective phases of the exchange as closed transactions, i.e., to treat the disposition of securities as a sale at the then market value, and the acquisition of the new securities as a purchase at the then market value. While in certain circumstances the procedure in determining taxable gain or loss might permit of the acquired securities taking the base of those exchanged, the accounting treatment accorded the transactions on the books of the company should, nevertheless, comply with the principle stated.

Answer No. 2: We think it would not be good accounting practice to record the new securities on the books at a value equal to the securities which were exchanged, subject to whatever cash adjustment there may be. It seems to us that a profit or loss should be registered when securities such as those mentioned in your letter are disposed of either by sale or by exchange, that profit or loss to be measured by the fair value of the consideration to be received. The fact that the disposition of these securities is effected by an exchange does not, to our mind, alter the conclusion that there has been a consummated transaction, resulting in a loss (in this case) to the trust, and that the new securities should be recorded on the books of the trust at their fair market value as of the date of the exchange.

CASH SURRENDER VALUE OF LIFE INSURANCE ON BALANCE-SHEET

Question: A corporation carried an insurance policy on the life of a former officer. This policy had been carried for a considerable time and had a substantial cash surrender value. The corporation had borrowed money from the insurance company on this policy. The insured became permanently disabled and the corporation called upon the insurance company to meet the terms of the contract, the insurance company, naturally doing its best to protect its own interest and pay out no money for which it was not contractually liable.

At the close of the corporation's fiscal period, when the audit was made, the controversy was in progress, and a short time later, in the next fiscal period, the insurance company acknowledged liability and made a cash payment and cancelled the outstanding notes on the policy.

The accountant, in his report, listed the surrender value of the policy as an asset and the notes outstanding against the policy.

What notation, if any, should be made on the corporation's balance-sheet or what comments should be made in the report concerning the controversy between the corporation and the insurance company and the subsequent settlement?

Answer No. 1: It is my understanding that the question which reads in part —"What notation, if any, should be made on the corporation's balance-sheet, etc. . . ."—is intended to refer to the balance-sheet and to comments included in the auditor's report.

There are several possible interpretations of the question. The first paragraph states "The insured became permanently disabled," and it then refers to the "terms of the contract" without furnishing complete information as to what the terms were.

If it be assumed that the corporation was asking for payment by the insurance company of the excess of cash-surrender value over loans made in accordance with amounts shown in the balance-sheet, and if the settlement was made before the auditor's report was completed, then it would hardly seem necessary for the auditor to make any special reference to the controversy in his report.

On the other hand, if the insurance policy carried a "disability" clause or some other provision under which the corporation was claiming an amount substantially different from any shown in the balance-sheet or one which could be computed therefrom, then I believe different procedure would be in order. In such circumstances it would seem to me that if the auditor's report was actually completed prior to the time of settlement of the controversy between the corporation and the insurance company the auditor's duty would be reasonably fulfilled if, in his comments, he stated the amount which the corporation was claiming from the insurance company, gave a brief statement of his understanding of the controversy, and indicated the effect which the corporation's winning or losing the controversy would have on the balance-sheet.

If, on the other hand, the controversy related to amounts different from those on the balance-sheet and was settled before the completion of the auditor's work, it would seem to me that it would be advisable for the auditor to include in his comments a brief statement as to the result of the settlement and to indicate the effect of the settlement upon the balance-sheet. If the amount of the settlement was sufficiently large to affect substantially the results shown by the balance-sheet, then it might be well to state in a note on the balance-sheet the date of settlement, the fact that settlement had been made and to indicate the effect of the settlement on the balance-sheet. I think that decision as to whether notation should be made on the balance-sheet or only in the comments would have to depend upon opinion and judgment in the light of all of the circumstances in the case.

The foregoing paragraphs are written on the assumption that the delay in payment was due to a real controversy and not merely to time consumed in furnishing required proof of a fact, such as disability; also on the assumption that the amounts involved are large enough to be of importance in the balance-sheet. If the amounts are relatively unimportant, then it might be unnecessary for the auditor to comment upon the matter at all or to make any notation regarding it upon the balance-sheet.

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Canadian Chartered Accountant, 10 Adelaide Street East, Toronto, Canada.
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